

# ECONOMIC DEVELOPMENT AND CULTURAL CHANGE

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RESEARCH CENTER IN ECONOMIC DEVELOPMENT AND CULTURAL CHANGE  
THE UNIVERSITY OF CHICAGO

## ECONOMIC DEVELOPMENT AND CULTURAL CHANGE

A journal designed for exploratory discussion of the problems of economic development and cultural change. Preliminary versions of research findings and research hypotheses are welcomed in the interest of provoking constructive and fruitful discussion.

Bert F. Hoselitz, Editor

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## INTRODUCTION

In Asia, it is said, economic development is the moral equivalent of war. Certainly, these countries, wracked by tribal and linguistic divisions, need some unifying passion, other than the older means of aggrandizement, which can promise some hopeful future. But such need also brings dilemmas. Can one have rapid growth without coercion; must one sacrifice enduring elements of traditional culture in order to industrialize; can one minimize disruptions-- and if the answer to these questions are largely in the negative, are the social costs involved too high for the narrow economic goals which have been specified.

The Congress for Cultural Freedom, a worldwide organization of free intellectuals, regards these problems as crucial for the free world. And hence, with the aid of the Ford Foundation, it convened an international seminar in Tokio, in April 1957, to discuss these questions. The seminar brought together for a week twenty-five distinguished economists and social scientists whose major interest has been in the field of socio-economic development. Sixteen papers had been prepared beforehand. These ranged from such technical questions as capital-output ratios to broad considerations of the role of the intellectual in economic development.

This issue of ECONOMIC DEVELOPMENT AND CULTURAL CHANGE presents a number of the papers which illustrate the range of the conference. It is the hope of the sponsors of the conference to bring out next year a volume containing all the papers and the transcript of the discussion. The paper by Professor W. Arthur Lewis presented here is taken from the transcript. It sums up the discussions at Tokio, and represents, we feel, a clarification of the major problems that have confronted economists and planners working in the field of economic development.

The participants in the Tokio conference were:

W. Arthur Lewis, University of Manchester, Chairman  
Peter Bauer, Gonville and Caius College  
Abram Bergson, Harvard University  
Rudolf Bicanic, University of Zagreb  
Colin Clark, University of Oxford  
M. L. Dantwala, University of Bombay  
Amlan Datta, Calcutta  
D. R. Gadgil, Gokhale Institute of Economic Science  
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Ayo Ogunsheye, University College, Ibadan

Saburo Okita, Tokio

M. L. Qureshi, Karachi

Paul Rosenstein-Rodan, Massachusetts Institute of Technology

Edward Shils, University of Chicago

D. Sumitro, University of Indonesia

Tun Thin, Rangoon University

Daniel Bell

Columbia University



## PROSPECTS AND PROBLEMS OF LAND REFORM IN INDIA

The major concern of this paper is with the problems of agricultural productivity, land reform, and community development, as they arise in the process of economic growth in India.

The chief aspect of the problem examined here is the one regarding the balance between agricultural development and development in the other sectors of the economy. The concept of balance is as yet not quite precise. "In essence, however, balance appears to mean minimizing of waste of productive resources that results when one sector of the economy acts, for an unnecessarily long time, as the effective limiting factor (bottleneck) on the growth of the other sectors."<sup>1</sup> We shall discuss the question of balance in India's planning effort, in the context of this meaning.

The allocations of public expenditure in the Second Five Year Plan clearly indicate a shift of emphasis from agriculture to industry. Industrial and mineral development together with transport and communications account for nearly half of the total expenditure in the Second Plan, as compared to about one-third in the First. (The actual outlay for industries and mining in the public sector during the First Plan was less than half of the allocation. This would make the shift even more pronounced than is indicated by the plan figures.) On the other hand, irrigation and schemes directly related to agricultural development now account for one-fifth of the total outlay as against one-third in the First Plan. The advisability of such a shift in emphasis has to be judged by reference to the current state of the economy and the requirements of development in the next stage. When the First Plan was formulated, shortages of food and essential raw materials were a serious problem. The need to curb the inflationary situation was equally imperative. The improvement both in the food supply and the general price level towards the end of the First Five Year Plan provided a more favorable base for projecting the Second Plan. The question which must receive serious attention is whether the development envisaged in the agrarian sector will be commensurate with the demand that may be generated as a result of the overall development.<sup>2</sup>

1. Ansley Coale and Edgar Hoover, Population Growth and Economic Development in India (preliminary draft, privately circulated), 1956. Office of Population Research, Princeton University, Princeton, N. J.
2. As originally envisaged, during the Second Five Year Plan, production of food grains was expected to increase by 15.4 per cent. A last-minute post script however was added to say that attempts should be made to increase agricultural production by 40 per cent. Commending this re-shift in emphasis to the National Development Council, the Prime Minister observed: "We shall have to work with our sweat and blood to increase our agricultural production; and if we do not, we just do not get on with the Plan. Here is a patent fact. The choice is for us to get on with the Plan by increasing agricultural production, or not to get on with the Plan. There is no other way out."

I. The Targets

The most recent estimates of the proposed increase in agricultural production are 24.6 per cent in foodgrains and 27.8 per cent in total for all agricultural commodities. It is difficult to judge, with any measure of confidence, whether this increase will be adequate in the light of the probable developments during the next few years in the Indian economy.

The major factors relevant for assessing the adequacy of production targets are (i) increase in population, (ii) increase in per capita incomes, and (iii) redistribution of incomes. But in making quantitative estimates a much more detailed analysis would be necessary. For example, the probable increase in food consumption by the farmers and non-farmers will have to be separately calculated. A separate estimate would be necessary for consumption by the old population and that by the addition to the population. A distinction will have to be made between the money demand for food and the demand for physical quantities of various ingredients of the food basket. In the absence of a system of compulsory procurement and rationing, account will have to be taken of the probable trade demand which may assume a speculative character.

In view of the complexity of the problem and the lack of reliable data, not much useful purpose will be served in attempting to forecast with any precision the quantities of food and other raw materials that would be needed to preserve the balance between agriculture and the rest of the economy. In a recent article, the additional requirement of cereals during the Second Five Year Plan, for example, is estimated at 8 to 9.5 million tons, as against the revised target of 15.4 million tons now adopted by the Planning Commission.<sup>3</sup> Professors Ansley Coale and Edgar Hoover, in examining the question of balance between agricultural and non-agricultural development,<sup>4</sup> question whether the course of development envisaged in the agricultural sector is likely to exercise any important constraints upon development in the rest of the economy, or *vice versa*, in the course of the next two or three decades. Their findings, given with full awareness of the numerous limitations, must be read, however, in the light of the procedures followed in seeking the answer and stating explicitly the large number of assumptions involved in the process.<sup>5</sup> The overall judgment of these two very important observers is:

- (i) Agriculture is unlikely to exert a constraint on non-agricultural development that would discourage the latter from growing by 150 per cent or even 200 per cent, as agriculture grows by 100 per cent. If this occurred during the next twenty-five years, with a population growth of 60 to 66 per cent, the average annual growth of per capita income would be about 1.3 to 1.7 per cent per annum.

- (ii) There is considerable flexibility, perhaps even above these limits, in the faster growth of non-agricultural output and of total output relative to

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3. R. Dayal, "Demand for Food in the 2nd Five Year Plan", Agricultural Situation in India, October 1956.

4. Coale and Hoover, op. cit.

5. These are discussed in a brief note in Appendix II.

agriculture. This may result from a net imports of agricultural products, probably associated with a rise in the ratio of farm to non-farm prices.

- (iii) The rate of population growth in the next few decades may well be important in determining how fast the non-agricultural sector can progress relative to agriculture's progress. A very rapid growth of population might seriously restrict the possibilities of increasing the ratio of non-agricultural to agricultural output.

The above considerations indicate that the answer to the question of adequacy or otherwise of agricultural production during the next two or three decades or even during the Second Five Year Plan, despite the best professional competence, involves a big element of judgment.

All that one may say is: Dayal's figure of probable demand for foodgrains by the end of the Second Five Year Plan errs on the side of underestimate; and the same is the case with Coale and Hoover's estimate of the possible rate of increase in agricultural production. During the period from 1949-50 to 1955-56, foodgrains production increased from 54 million tons to 65 million tons, or by 20%. The index of production for all agricultural commodities during the period rose from 96 to 114. During the Second Five Year Plan, if the revised targets are realized, foodgrains production will have increased to 80.4 million tons by 1961-62, giving a decennial average rate of increase of a little less than 50%. It should, therefore, be not at all difficult to double the production of foodgrains in the next two decades, or even earlier.

Results for other agricultural commodities, during the First Five Year Plan, have been even better. True, these have been helped by a favourable sequence of good monsoons, but not so exceptional as is sometimes believed. But the main point is that in such forecasts of future possibilities, too much reliance on previous records is likely to lead to serious underestimates.

One always learns by past experience and improves upon it, especially during a period of dynamic upsurge, such as India is experiencing. Besides, as far as agriculture is concerned, the limitations imposed by scarce resources like capital and technique are not so serious as on other sectors of the economy. Paradoxically, for the rate of growth, the very backwardness of agriculture is a favorable factor. There is so much scope for the wider application of known techniques, involving hardly any additional capital investment, that in the initial period, at any rate, progress can be very rapid.

The only bottleneck is organization, for which the main resource needed is human endeavor. There is no reason why, for example, the use of farm yard manure cannot be increased ten-fold within a year or two. Thousands of tiny schemes of soil conservation and improvement can be undertaken with spare-labor input constituting 75% or more of the cost. This is being done, without much publicity, more widely than even many in India realize. One such example is provided by the reconstruction effort in the Gramdan Villages in Korapat District of Orissa. A nation which could give 5 million acres of land in free gift to a Wandering Sadhu is capable of contradicting the most scientific forecast of learned men.

## II. Land Reforms

The avowed objectives of land reforms are: (1) to increase efficiency of agriculture, (2) to secure social justice, and (3) to promote economic development. Though these objectives appear to be inter-related and mutually complementary, it would be a mistake to believe that any given measure of land reform will fulfill all the objectives. It is even possible that while fulfilling one objective, it may retard the other, at least in the short run. If so, questions will arise as to the priorities amongst the objectives, and the answers will depend upon the prevailing social, political, and economic situation in the country.

If political stability is assured, attention may be directed towards measures for increasing agricultural productivity. If, on the other hand, there is evidence of social unrest which could be removed by land reform measures, the objective of productivity may have to be relegated to a secondary position.

Attention may, however, be invited to one aspect of this question. In countries where the most rapid economic development is the primary objective of planning, either for reasons of security or ideological dogma, there is a temptation to adopt measures of land reform whose sole objective is to collect maximum surplus from the agricultural sector to serve as capital for building up heavy basic industries. Under these conditions, the interest of the peasantry and even the efficiency of agriculture assume a secondary importance. But, as the recent experience of the East European countries shows, such land reforms may defeat their own purpose in the long or even the short run. Yet often the obsession of rapid economic development, equated with capital formation, is so intense that it develops a total unconcern for other objectives of land reform. One would, therefore, be justified in suggesting that no land reform would be considered as progressive which ignores the welfare of the peasantry--by which we mean all those who put in their labor in agricultural production.

The progress of land reforms in India may be considered under the following headings: (1) abolition of intermediary tenures; (2) regulation of tenancy; and (3) ceilings on holdings, redistribution of land, and cooperative farming.

The earliest series of legislation pertaining to land reforms sought the abolition of the intermediary or the zamindari tenures. As a result of this legislation, the proprietary rights of the zamindars are acquired by the State on payment of compensation and the statutory tenant or the tenant-in-chief is brought into direct relationship with the State. The area involved in the process of abolition is 173 million acres; and the amount of compensation would be in the neighborhood of Rs.435 crores.

An erroneous impression, however, seems to prevail that with the abolition of the zamindari tenure, landlordism in India will have disappeared. The justification of the abolition was not that the zamindars were big land-holders, but that their rights were considered to be legally and morally dubious. In fact, in one of the major zamindari States, Uttar Pradesh, more than 85% of these zamindars paid annual land revenue of not more than Rs. 25 to the State. On the other hand, there were a large number of big land-holders in the ryotwari area who, if they can establish that they were cultivating the land personally, are as yet unaffected by any legislation enacted hitherto. Secondly, the zamindari



abolition legislation permitted, often without restriction, retention by the zamindars of what is known as sir and Khudkasht lands which were supposed to be under the personal cultivation of these zamindars. Though a larger number of these zamindars had no such land or only a little of it, this provision of the Act has been subjected to severe criticism and it has been suggested that "a new hierarchy of tenure holders has been substituted for the old one". In fact, the land under sir and Khudkasht in no State constituted more than 10% of the area involved in abolition, though in individual cases it is possible that the land retained by some of the old zamindars under this provision of the Act is quite substantial. Similarly, objection has been taken to the vast amount of compensation given to the zamindars. The aggregate amount of Rs. 435 crores to be paid in compensation is certainly very large, but it should be noted that for an area of 173 million acres the average comes to a little more than Rs. 25 per acre. Once again, there are individual cases where the amount of compensation is very large, for which it is difficult to find justification. The basis of compensation was a sliding scale multiple of the net revenue received by the zamindar. For the zamindars in the highest income brackets, this was in some cases as low as 2. The statutory tenants who have now acquired the occupancy rights will be paying land revenue directly to the State, the amount being the same as that paid by them in rent to the zamindars.

In a way, therefore, there has not been any financial gain to the tenants, except for the fact that now there is no scope for several illegal exactions which were usually imposed by the zamindars. The tenants have also the right to purchase from the Government full proprietary rights on payment of a price equivalent to eight or ten times the rent. On the acquisition of such rights, the land revenue paid by them to the state will be reduced by 50 per cent. Fresh leasing by the new occupants is prohibited, and the provision is made for the existing sub-tenants where they exist to purchase occupancy rights by payment of compensation or a price. Thus, though there are some features of the zamindari abolition legislation which admit of some criticisms, by and large the change brought about by it can be considered as truly revolutionary; and it can be said without hesitation that the ownership pattern in the ex-zamindari areas is much more equitable and free from some of the worse features of feudal exploitation.

While there was hardly any opposition to the reform for the abolition of zamindari, except by the zamindars, there is considerable resistance to the tenancy legislation recommended in the Five Year Plan. This is so because the legislation is likely to affect adversely the interests of a class of land-owners in the ryotwari area, who lease out their lands and have a substantial rental income, a class which has some influence in the social and political life of the country.

The primary aim of this legislation is: (1) to regulate (reduce) rents; (2) to provide greater security of tenure to the tenants; and (3) where the landowners have a large amount of land under their personal cultivation, to permit the tenants to purchase the land taken under lease.

Before the legislation, the most common rate of rent was 50% of the gross produce, the tenant bearing almost all the cost of cultivation. There were instances in which this percentage was as high as 70 to 75. The level of rent recommended under the First Five Year Plan was one-third or one-fourth of the gross produce, according to whether the land was under irrigation or not. In

Bombay State, the tenancy legislation places the upper limit of rent at one-sixth of the gross produce. But in the most recent tenancy legislation in Andhra and Madras, the stipulated percentage of permissible rent is 40 and 45% respectively. In the matter of security of tenure, the minimum period of lease is stipulated at 10 years in Bombay and 5 years in Madras. Tenants who have been in continuous possession of the leased land for a certain minimum number of years are given occupancy rights and the land-owner cannot resume the land from them unless he needs it for personal cultivation. Even this right of resumption for personal cultivation is restricted by (1) the amount of land under the personal cultivation of the landlord, and (2) the tenants' right to retain some minimum area for their own use. The tenancy legislation in several States also provides for the tenant's right to purchase the leased land at reasonable prices. Some State governments have ignored the recommendations of the Planning Commission and have enacted legislation which is more favorable to the landowning classes. But the most serious aspect of the entire problem is the almost universal lack of enforcement of the main provisions of the legislation.

Both official and non-official opinion accepts the fact that a large number of tenants pay much higher rents than those prescribed by law. As for the security of tenure, there have been more evictions and changes of tenants during the years following the tenancy legislation than in any previous period in recent history. Many of these were in years intervening the announcement of the intention to legislate and the actual enactment. The landlords attempted to forestall the accrual of occupancy rights (to the tenants) which was conditional on continuous possession of lease for a certain minimum period. Even after the enactment, the superior economic and social position of the landowning class enabled it to secure "voluntary" surrenders of tenancies.

The inability of legislation to reform the agrarian structure effectively has many lessons for planners and students of economics. For one thing, if violence is to be ruled out--as it must be--in bringing about a socio-economic change, equally effective democratic sanctions must be devised. In addition, the disadvantaged group must become conscious of its rights and must be able to defend them, at least when they are legally confirmed. Secondly, though in democracy the process of decision making must involve a rather lengthy period of discussion and debate, often further prolonged by reference to the judiciary for testing their legal and constitutional validity, precautions must be taken to see that advantage of the intervening period is not taken by vested interests to queer the pitch and defeat the purpose of reform. To cite one more example of such a danger, landowners are just now busy partitioning their land amongst every member of their family--major, minor, and prospective--to forestall the ceilings legislation, recommended nearly five years back, but which may take another five years to get enacted.

The imposition of a ceiling or the maximum limit to the individual ownership of land will be the most important plank in land reforms proposals of the Second Five Year Plan. Though a general recommendation was made in favor of this measure in the First Five Year Plan, hardly in any State was legislation enacted for imposition of ceilings regarding the question of the level at which the ceiling should be imposed. The final draft of the Second Five Year Plan recommends that "each State should specify according to the conditions of different regions, classes of soil, irrigation, etc., the area of land which may be declared to be a family holding". This latitude, it is feared, will lead to a great deal of



divergence in the legislation of different States, a divergence not necessarily justified in terms of regional conditions. It would even be possible to defeat the very purpose of the ceiling legislation by a convenient definition of family holding. There does not appear to be much enthusiasm on the part of State governments to enact legislation, for the imposition of a ceiling on individual ownership of land seems to stem from the fact that similar restrictions are not yet seriously considered for the other sectors of the economy. It is also contended that any such restriction would penalize enterprising and efficient farmers and adversely affect agricultural production on which much of the success of the Plan depends. Besides, the amount of land which would be available through the imposition of a ceiling would be relatively so small that its redistribution will be far too inadequate for appeasing land hunger, which appears to be the major objective of the proposal. Moreover, if this surplus land is redistributed in small fragments among landless laborers, it will only accentuate the problem of small holdings.

As against this, it may be pointed out that with the exemptions provided for plantations, orchards, cattle breeding, and dairy farms, and "efficiently managed farms, which consist of compact blocks on which heavy investment or permanent structural improvements have been made, and whose break-up is likely to lead to a fall in production", the adverse effect of the application of ceilings on production would be minimized, if not completely eliminated. Secondly, since compensation is to be paid for the acquisition of the "surplus" land acquired, it cannot be contended that the intention of the proposal is to limit either the income or the wealth of individual farms. There are very few farmers in India who personally cultivate an area of land--in non-exempted categories--larger than three times the family holding, which is generally suggested as the level of the ceiling. Most of the big landowners lease out their land and in their case the problem of acquisition of excess land does not arise because the tenancy legislation, suitably amended if necessary, prohibits resumption of land from the tenants. In any case, with the climate created by the Bhoodan Movement for the total surrender of ownership rights in land, the proposal of the Planning Commission for imposition of ceilings is not likely to be considered as very radical by a large mass of public opinion in India.

The portion of land reforms program of the Planning Commission which needs careful watching is the one relating to Village Management, the ultimate objective of the Plan. While explaining the meaning and content of this ideal, it is stated that: (1) Cooperative Village Management assumes that the ownership of land belongs to peasants. (2) A distinction should be made between the unit of management and the unit of operation. Thus, even when a larger area of the village as a whole becomes the unit of management, for many years, the common unit of operation may be the peasant holding. (3) Once the stage of Cooperative Village Management is reached, the distinction between those who have land and those who are landless will lose much of its significance. A rural economic structure is visualized in which agricultural production, village industries, processing industries, marketing and rural trade, are all organized as cooperative activities.

During the transition to Cooperative Village Management, land in the village will be managed in three different ways. Firstly, there will be the individual farmers cultivating their own holdings. Secondly, there will be a group of farmers who pool their land voluntarily in their own interest into cooperative

working units. Thirdly, there will be some land belonging to the village community as a whole. This will include, among others, lands whose ownership or management is entrusted to the village on the application of the ceiling on agricultural holdings. Thus within the scheme of land management in each village, there will be an individual sector, a voluntary cooperative sector, and a community sector. "The aim would be to enlarge the cooperative sector until the management of the entire land in the village becomes the cooperative responsibility of the community." In other words, quantitative changes will become qualitative and expanding cooperative sector will become a community sector in which, as euphemistically stated, the distinction between those who own land and those who do not will tend to disappear.

For the last few years, one of the principal objectives of our land reforms was to eliminate the dichotomy between ownership, operation, and management. For we believed that both in the interest of production efficiency and social justice, best results would be achieved when those who manage the land also own it and vice versa. One can understand that under a socialist pattern of society, the rights of ownership cannot be absolute and must be subject to social control and conform to social policy. But an arrangement under which land belongs to the peasant, but is managed by the village (Panchayat), would be no better than a variant of Soviet collectivization of agriculture.

From the above it would be evident that a clearer statement of policy is necessary, unless of course the Planning Commission believes that it is enough for the distant to be enchanting. Firstly, it is necessary to make up our minds as to whether under the ultimate ideal land will belong to the tiller, who will be free to manage and operate it within the framework of overall social and economic policy, or whether the land will belong to the village or the village community and also be managed by it. Phrases like "cooperative management" and "integrated social and economic structure" are no doubt ennobling, but do not carry much meaning unless concretely defined. Secondly, even if it is necessary to entrust the overall management of agrarian policy to the village community, it is absolutely essential to clearly define the respective rights of the individual and of the community. For in actual practice, rights entrusted to the village community will be exercised by a representative body like the Village Panchayat, subject to all the frailties of an elective institution. The possibility of the distortion of an ideal in the process of institutional implementation must not be a think unknown to the Planning Commission. Under the Soviet collectives also, land belongs to the community, and the Machine Tractor Stations (M.T.S.) provide the needed integration. Is that the ideal we are aiming at? It may be argued that since authority of management is vested in a democratic and decentralized institution like the Village Panchayat, there may not be conflict between the interests of the individual and that of the village community. Decentralization of authority is undoubtedly a big step in the direction of establishing a democratic society. But it should never be forgotten that in the ultimate analysis, the strength of democracy will lie not so much in institutions however decentralized and benevolent, but in the free individual managing his own affairs in conformity with the values of a democratic socialist society.

Our discussion of land reform trends in India will remain incomplete without the consideration of the Bhoodan Movement led by Vinshe Bhane. The primary aim of the Movement is to bring about a change in the attitude of the people towards the ownership of land. The Movement propagates the view that the land

belongs to the entire community and that there should be no private ownership of land. As a first step in the realization of this revolutionary change, landowners are persuaded to give a donation of at least one-sixth of their land to the Community Pool. Such an appeal, it may be noted, has no other sanction except the moral one, and yet the response to it has been phenomenal. To date, more than 4 million acres of land has been donated by landowners. Last year, the appeal was broadened, and all landowners in the village were persuaded to donate their entire land to the Community Pool. Even this has succeeded, and the entire land in nearly 1,800 villages has been given in what is known as Gramdan. Very recently, the demand has been further stepped up, and there is a call to donate the land of all the villages in a firma or a taluka.

In a country where land is so scarce and there is such a scramble for its ownership and possession, it is indeed remarkable that free gifts of such a vast amount of land should have been made within a short period of three to four years; not only without any coercion, but even without the sanction of any legislation. Lands so collected are distributed primarily to landless laborers. To avoid the possibility of any mala fide practices, the distribution takes place in an open air meeting where all the village folk gather. In the Gramdan villages where the entire land of the village has been received in donation, land is redistributed for individual cultivation to all those who depend for their livelihood on farming. The distribution is according to the needs of every family, as determined by its size. Though it has not been possible to adhere strictly to the egalitarian principle in the distribution of land, the inequalities in ownership have been greatly reduced. A portion of the land is set aside for community farming, its actual extent being decided by the village people themselves.

One of the major criticisms of this Movement is that its insistence on providing land to everyone who wants it will result in extreme fragmentation of the land surface, adversely affecting its productivity. It is also true that the leaders of the Movement are concerned more with creating a climate for the acceptance of the moral principle of voluntary surrender of proprietary rights in land. Not much attention is paid to the task of rehabilitation of the new recipients of land through arrangements for the supply of credit, draught animals, and other implements required for farming. As most of these recipients are landless laborers, they do not possess the wherewithal for the cultivation of land.

The net outcome of all these efforts in the sphere of land reforms is uncertainty as to the future intentions of the Government in regard to land reforms to come, as well as in regard to the willingness or ability of the Government to translate into action those intentions which are already embodied in legislation. This uncertainty in its turn has created a situation in which neither the landowners nor the tenants are in a mood to concentrate on the task of augmenting agricultural productivity and capital formation. As for the landless laborers, their hopes have been aroused, but the chances of their fulfillment are remote.

### III. The Reorganization of Credit and Marketing

It is a universal experience that measures for the reforms of land tenure such as redistribution of land or provision of security to the tenants, do not yield expected results unless accompanied by supplementary measures in the sphere of credit and marketing. Plans are fairly comprehensive and even ambitious.

Fortunately, in shaping these plans, the Government and the Planning Commission had the advantage of a very comprehensive survey and recommendations made by an expert committee appointed by the Reserve Bank of India.

The pivotal finding of the Rural Credit Survey was that "co-operation has failed but Co-operation must succeed". One of its major recommendations was therefore for the creation of an all pervasive State-partnered Cooperative Movement encompassing cooperative credit, cooperative processing and marketing, and cooperative storage and warehousing. This recommendation flows from the conviction that the cooperative movement will be able to make an effective contribution to the problem of rural credit and marketing, in fact to the entire problem of rural reconstruction, only if it is fully backed by the State. The erstwhile attitude of "over-administer and under-finance" must give way to an active and effective partnership. The State, as a partner, would be expected to provide not only the initiative for the establishment of a national network of cooperative institutions but also the financial support and bear the risk inevitable in the adoption of such an extensive as well as intensive program of cooperative development. At the essential part of this program, it should bear the responsibility of making adequate arrangements for the training of cooperative personnel at all levels.

Clarifying this point, the Rural Credit Survey Report states "the line of solution, therefore, would seem here to be that of the State taking up the gap in the requirements of share capital, technical assistance, administration, and organization to such an extent that immediate strength is imparted, but in such a manner that this paves the way for the co-operative forces to gather strength and gradually replace the finances and services made available initially by the State. An effective programme is possible only if the State at one end joins hands with co-operatives at the other in an effort to bring about the rural mindedness that is needed." This State partnership with cooperatives in credit, processing, marketing, etc., is to be supported by two other major institutional bulwarks in the field of banking and warehousing: the State Bank of India--nationalized Imperial Bank of India--and the National Cooperative Development and Warehousing Board.

The long-term goal is to bring within 15 years 50% of the total rural business, including credit, processing, marketing, and warehousing, within the cooperative sector.

#### IV. Community Development

During the First Five Year Plan, the Community Development and National Extension Projects have covered 122,957 villages, with a population of 79.8 million. The program covered agriculture and animal husbandry, land reclamation, irrigation, health and sanitation, education, communications, village housing, and development of cooperatives. The physical achievements, in at least some of these fields, are quite impressive. For example, in agriculture and animal husbandry more than a million compost pits were dug and nearly 7 million maunds of fertilizers and 3 million maunds of improved seeds were distributed. Nearly a million acres of land was reclaimed and 1.6 million acres of additional land was brought under irrigation.



But it has been emphasized again and again that the success of the Community Development Projects is not to be judged by reference to these physical achievements. Their fundamental objective is to create in village communities an awareness and interest in the local problems, stimulate desire and initiative in tackling these problems and develop a new dynamism amongst the village people as the only sure method of initiating and sustaining an all-round growth.

During the Second Five Year Plan it is proposed that the entire country should be served by the National Extension Service, and that not less than 40% of the National Extension Blocks should be converted into Community Development Blocks. The Plan provides a sum of Rs. 200 crores for implementing the program. At present a staff of 80,000 persons is engaged in this movement, and during the Second Five Year Plan this number is expected to go up to about 200,000. It is claimed for the movement that on it depends the success of the momentous social and economic revolution and the survival of democratic processes to which India is committed.

Is this an exaggerated claim? Has the movement succeeded in bringing about that social and psychological transformation in the rural community which is held to be its primary objective? One of the unique features of this program is that it is being constantly subjected to systematic evaluation by official and non-official agencies in India as well as by some distinguished foreign experts. Their verdict has not been cent per cent approval of what has been done. Some aspects of the program have been severely criticized, but there is an overwhelming consensus that the movement is progressing on right lines and has the potentialities of fulfilling the hopes placed in it.

One of the most persistent criticisms of the movement is that it helps only the better-off classes, and the lower income groups do not derive commensurate benefits. Land Reforms have been kept outside the purview of the movement and this, it is contended, has considerably hampered the movement in becoming a genuinely peoples' movement. It is perhaps inevitable that any reform or reconstruction activity will benefit, at any rate in the first instance, those who are in a position to take advantage of the programs initiated by it. This was noticed even in the Sarvodaya Movement, whose guiding motto is "Unto the Last". It is, however, extremely significant that this flaw in the Community Development Program was first noticed and publicized by the official Evaluation Organization. An administration which not only permits but initiates critical evaluation of its own achievements and does not hesitate to give full publicity to it can be depended upon to correct its past mistakes and benefit from them.

As for the land reforms being outside the jurisdiction of the Community Project Administration, it is contended that, as far as possible, those in charge of constructive activities should not get involved in matters which are controversial and which have in them seeds of tension and conflict. Land Reforms (whatever their limitations may be as discussed above) are being introduced by the Government as an independent, though a supporting program. It is also not denied that the removal of inequality and injustice in agrarian relations is a condition precedent to the success of constructive program of development. Apart from the question of whether the two functions of implementation of land reforms program and that of the Community Development should be combined in a single authority,

the fact remains that the half-hearted enforcement of land reforms, their ever changing content, the uncertainty and the dislocation in agrarian relations have hampered the Community Development Program in extending its benefits to the disadvantaged group in rural communities.

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Appendix I. Demand for Food at the End of the Second Five Year Plan

|   |   |
|---|---|
| 1. Increase in National Income  | 25%   |
| 2. Increase in Consumption Expenditure  | 20%   |
| 3. Ratio of total population to old population  | 1.06  |
| 4. Increase in consumption of old population $\frac{(120 - 100)}{1.06} =$                   | 13%   |
| 5. Elasticity of food expenditure   | .75 to .85                                    |
| 6. Percentage increase in expenditure on food<br>$(100 + 13 \times .75) 1.06 = 116.6$       | 16 to 18%                                     |
| 7. Elasticity of expenditure on cereals   | .40 to .65                                    |
| 8. Increase in money demand for cereals<br>$(100 + 13 \times .40) 1.06 - 100 = 11.5$        | 11.5 to 15%                                   |
| 9. Increase in quantitative demand for cereals  | 10 to 13%                                     |
| 10. Necessary increase in cereal production   |   |
| a. Increase in demand due to income factor<br>- 46.7 (consumption in 1955-56) $\times 10 =$ | 4.8 million tons                              |
| b. Addition for feed  | .5 million tons                               |
| c. Additional trade demand  | 2.0 million tons                              |
| d. Total demand   | 7.3 million tons                              |
| e. Addition for seeds, etc. $\frac{7.3 \times 11}{100} =$                                   | .7 million tons                               |
| Total Additional Requirement  | 8 million tons                                |
| Total Production Targets  | 8 to 9.5 million tons (elasticity .40 to .65) |

Source: Dayal, op. cit.

Appendix II

Professors Coale and Hoover give two sets of calculations: one based on a formula devised by Dr. Egbert De Vries (in a mimeographed paper, "The Balance between Agriculture and Industry in Economic Development") and another based on the objective of self-sufficiency of Indian economy, implying that (1) farm products, and (2) other products must be produced in India in approximately the same proportion and amounts in which they are consumed there. Further,



both these formulae can be worked with differing assumptions: three such assumptions are crucial to the results and we state them below:

- a. During the next two or three decades, population will increase at the rate of 6 per cent per quinquennium or by 26 per cent in twenty years and by 34 per cent in twenty-five years. This is the assumption of the Planning Commission.
- a'. Population will increase by 63 per cent in the next twenty-five years. Coale and Hoover assumption followed in applying the formulae.
- b. Farm output will double in twenty years (Planning Commission).
- b'. Farm output will double in twenty-five years (Coale and Hoover).
- c. Income elasticity of expenditure on food = .80

A brief tabular summary of the results of the application of the two formulae under the differing assumptions is given below:

|                     | b. Farm Output<br>doubles in 20 years |                    |     | b'. Farm Output<br>doubles in 25 years            |                    |     |
|---------------------|---------------------------------------|--------------------|-----|---|--------------------|-----|
|                     | a                                     |                    | a'  | a   |                    | a'  |
|                     | Planning<br>Commission<br>Estimate    | DeVries<br>formula |     | Planning<br>Commission<br>(Estimate<br>Projected) | DeVries<br>formula |     |
|                     |                                       |                    |     |   |                    |     |
| National Income     | 144                                   | 161                | 136 | (180)   | 150                | 120 |
| Agricultural Output | 100                                   | 100                | 100 | (125)   | 100                | 100 |
| Non-farm Output     | 188                                   | -                  | 168 | (170)   | -                  | 139 |

## THE MEDIATING ROLE OF THE TRADE UNION IN UNDERDEVELOPED COUNTRIES

In this paper I propose a role for the trade unions in underdeveloped countries which is at variance with trade union practices in the West. In the West, unions have either been political adjuncts for the Communist or Socialist parties, as instruments for power, or more usually, economic institutions to raise wages and protect the workers against the authority of the employer.

Neither of these roles is possible, I believe, in underdeveloped countries. There the chief problem is economic growth, and therefore, the major question for unions is subordination of immediate wage gains and similar considerations to the development of the country.

### I. New Factors, New Methods

A majority of unions in the underdeveloped countries restrict their activities to collective bargaining within the legal framework provided by national legislation on industrial relations. Most of the Asian countries have provided statutory machinery for collective bargaining.<sup>1</sup> Over-reliance of trade unions on Government machinery, however, is partly responsible for their weakness. In industrially advanced countries like the United Kingdom, the United States, and Sweden, the State's role is limited to setting up the machinery, within which the representatives of employers and employees negotiate and conclude collective agreements. In the underdeveloped countries, however, the industrial relations machinery gives the State an indirect weapon to control labor-management relations. The distrust between employers and employees, their reluctance to arrive at mutual agreement, and the active intervention of the State are contributory causes of State Control over industry and labor. Adjudication or arbitration in a dispute by a State official is widely prevalent in Asian countries. Voluntary collective agreements between the two principal parties are practically absent.

The desire of trade unions to play a decisive role in the economic growth of an underdeveloped country can only succeed if they are independent. No amount of State protection or employers' good-will will enable unionism to develop on right lines. Trade union movements in Asian countries suffer from various inherent defects, which must be removed before the unions undertake their rightful responsibilities in the economic growth of the country. The main defect of Asian trade unions are their unsound finances, low and irregular membership, faulty administrative and accounts work, lack of experience and maturity among union leaders, influence of outsiders, exploitation for political purposes, rivalry and multiplicity of unions, loose structure at various levels, absence of welfare work, and heavy reliance on Government machinery.

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1. For texts of the industrial legislation in Asia, see International Labour Office [Indian Branch], Asian Labour Laws (1951), New Delhi. A summary appears on pp. 211-234 of the book.

No doubt some of these defects are due to the difficulties created by Asian economies, namely, illiteracy and poverty, unemployment and underemployment, indebtedness, growth in population, migratory character, and caste and communal considerations. An improvement in these factors, which have been so far kept outside the ken of trade unions, will enable the unions to strengthen themselves. It will then be possible to have regular paid membership, to engage full-time leadership of career unionists, to grant adequate welfare benefits to its members, to wield efficiently and profitably the weapon of collective bargaining, and to exert sufficient political influence to get enacted legislation for the improvement in labor conditions.

The first priority thus is to cooperate with other parties with that aim. The role of the trade union, therefore, must be different from what it was under foreign rule. It is in their interest and in the interest of the country to render active cooperation in all development plans which aim at the prosperity of the country.

## II. The Role in Planning

Economic development by planning means state control over industries, because primarily it becomes the responsibility of the Government to promote, assist, and regulate the development of industry in the national interest. This is particularly so when the plan aims at a socialist pattern of society.

Most of the Asian countries which have recently gained independence have formulated such plans, and these plans place limitations on private sector, thereby widening the public sector. For example, the public sector in India comprised in 1947 the railways, the post office and telegraph system, the Reserve Bank of India, and Ordnance Factories. To this kingdom have been added the telephone system, the river valley power and irrigation developments, the airlines, life insurance companies, and the Imperial Bank of India. Besides, a number of new government factories for producing machine tools, penicillin, D.D.T., fertilizers, locomotives, newsprint, cement, cables, telephones, integral coaches, and finished steel have been set up. The gross assets of the Central and State enterprises in 1951 were estimated at Rs. 12.4 billion, in contrast to Rs. 14.7 billion of the private sector.<sup>2</sup> In addition, the Government of India has directly bought some private factories and substantially contributed to private enterprises through investment corporations financed wholly or in part by government funds.

What should be the trade union's attitude to this development, and what role should they play under the circumstances? Unfortunately the attitude toward labor problems of the State managers is much the same as that of private employers. Workers' expectations of getting a better deal are frustrated, and this is manifested in more strikes in the public sector. The profit motive is still there, because an ever-developing economy is in need of more money. The bureaucrats who manage the State industries bring in additional evils of red-tapism, routine, and impersonal attitude. The failure of nationalization is not so much due to the defect in the principle but to the way in which the matter has been handled by the State officials, who managed the industries, without any industrial and business experience.

2. Dr. N. Das, The Public Sector, Eastern Economist Pamphlet No. 32, p. 1.

As active partners in economic development, the trade unions should assist the State in removing the defects and streamlining the machinery for socialist patterns of society. They should explain to their members the implication of State Economy and urge the necessity of proving nationalization a success, by making the public sector profitable. In State-owned industries, there should not be any clash of interests between the manager and the managed, and full scope can be given to the joint consultation in industry and to workers' participation in management. The State, on the other hand, must be a model employer, and its present tendency of trying to get exemption from the provisions of various labor Acts should be discouraged. Government factories can be an ideal laboratory for experiments in wage incentives, productivity studies, job analysis and job evaluation, training methods, and time and motion studies. Trade unions can fully cooperate with the State in such constructive activities.

### III. Restraints on Consumption

Traditionally, economists have treated trade unions mainly as economic institutions. Hence it is no wonder that the economic and industrial functions predominate even today, in spite of the realization of the changing significance of trade unionism. The economic and industrial functions of the classical pattern are revealed by these three aims: raising the levels of wages; improvement in working and living conditions; and organization of unskilled masses of labor.

The efforts of trade unions of advanced countries to share in high industrial profits is understandable in view of the fact that by their claims they lower capital-output ratio and increase the labor-output ratio proportionately. In underdeveloped economies, no such bases exist for such legitimate claims. Inflationary pressures or deflationary situations are sudden in such economies, since they are subject to extraneous fluctuations. The lack of incentives and the backward techniques of production mean that the consumption, saving, and investment functions do not work with the same tempo as in developed countries.

In these particular circumstances, the role the trade unions can most usefully play may be as follows:

1. Observing self-imposed wage restraint on all levels;
2. Educating their members to give up extra-spendthrift habits of the labor class;
3. Encouraging small-savings among the classes;
4. Increasing the labor productivity through propaganda;
5. Settling the differences through the legally instituted machinery based on the principles of conciliation and/or arbitration;
6. Helping the displaced labor thrown out of employment as a result of rationalization by inducing them to take training in new skills in the institutions set up by the Government or State management;
7. Initiating cooperative action in the enforcement of minimum wages;

8. Inducing the labor class to effectively participate in social security and provident fund schemes; and
9. Sharing in the profits on an acceptable basis which, while apportioning a significant percentage of profit to labor, will leave sufficient incentive to the management to plow the profits back into the industries they own.

The economic implications of such trade union behavior are two-fold: (1) to restrict consumption, and (2) to bring about an increase in the desired levels of production. The restriction on consumption is most vital since any undue increase in the demand for consumers' goods or semi-necessities manufactured indigenously or imported from abroad may put an immediate pressure on the price-level as a result of demand outpacing the supply. Owing to the general physical bottlenecks that prevent the supply equating with demand, the pressure pushes the prices high enough to disturb the price-cost basis of a development plan. With a view toward holding the levels of income, price, and cost, the restriction on consumption is most essential. Such a restriction, moreover, is essential from another point of view, viz., in raising the size of savings necessary for capital formation.

The policy implications of the trade unions, in this context, therefore, assume major significance. In brief, the action of trade unions in the developing stages should be to forego the ideas of immediate gains at any cost.

This raises the broader question of whether the trade unions should follow policies favoring production or consumption. The trade unions in the West follow policies which favor consumption and are against production. The trade unions in the developing economies face the same choice today. But there is no difficulty in making the choice, if the choice is to be determined within the objectives of economic development. The economic picture of the underdeveloped economies shows that the general purchasing power of the population is low, the resources undeveloped, the techniques of production backward, and the efficiency of monetary controls ineffective due to lack of capital and stock markets and low state of banking. In such circumstances, any attempt to increase consumption of the population is likely to generate inflationary pressure, and with a resort to deficit financing, the gap between money in circulation corresponding to flow in production may assume menacing proportions. This danger becomes more apparent when one considers the physical bottlenecks leading to artificial shortages. The pressure, moreover, may lead to reduction in exports due to rising costs of commodities and the frittering away of resources on foreign imported goods. A reliance on consumption in a backward economy thus brings to the forefront in the accentuated form the cumulative shortages, increasing prices, increasing capital output ratio, and general inflation.

When considered thus, it becomes more desirable to start with the programs based in favor of increasing production. An emphasis on production-intensive programs is likely to avert all the pitfalls inherent in planning in a shortage economy and serves as insurance against all the unpleasant experiences of uncontrolled inflation let loose in the post-war period.

The necessity for the persuasive role of the trade unions becomes most imperative when it is considered that the programs of economic development of underdeveloped countries are normally capital-saving, rather than labor-saving in the initial stages of industrial development.



The cottage or small-scale industries which require less capital and less skill provide job outlets in urban and rural areas to the unemployed labor force. Policies intended to foster and develop the cottage industries raises the question of how best to secure cooperation between the organized and unorganized sections of the economy. Here too, what is required is the clear demarcation of the size and nature of unorganized economic activity as against organized activity. Any aggression by the organized section on this unorganized section is fraught with severe economic dangers, as the very basis of decentralized development which offers earning opportunities is threatened with disruption. A sympathetic attitude on the part of the State is most essential. State action must aim at fostering the growth of these decentralized units of production scattered in non-monetized as well as in monetized sectors of the country. A rise in the price level of consumers' goods, brought about as a result of this protection of unorganized sections, is likely to affect the workers' cost of living, of course, though not severely perhaps. In this eventuality the fresh demand for increased wages by trade unions may disturb the price-cost ratio of the industry setting this wage, and cost spirals may develop leading to inflationary conditions in the absence of effective monetary or physical controls.

#### IV. Political Role

As I have stated earlier, there has been a tendency on the part of political parties to exploit the trade unions for political ends. Doubtless the unions have certain legitimate political functions, and it may be undesirable to restrict their activities only to economic and industrial fields. Workers, when they accept employment under contract, do not cease to be citizens, and as members of the community have every right to exercise their civic and political rights. If they look up to the union for advice and guidance in these matters, it cannot be denied. Besides, the trade union method of legal enactment allows the unions to urge the labor representation in legislatures and to get progressive labor laws enacted. Some Asian trade union laws allow establishment of a political fund for limited political activities, e. g., payment of expenses for election to legislature of a candidate, or for maintenance of a member of the legislature.

These are legitimate functions. But fighting the elections on specific issues, forming the Government or the opposition, agitation and propaganda on political problems and similar issues should be left outside the trade union field. This demarcation is particularly necessary in underdeveloped countries, where unionism is apt to be radical in its orientation, in view of poor labor conditions and the impatience of workers with the seeming inability of the method of collective bargaining to secure for them immediate betterment.<sup>3</sup> The results have been the tendency to divert resources from investment to consumption, political influence of outsiders or non-workers in the labor movement, inability of the rank and file to rise to leadership, growth of trade unions by political shades, and growing labor indiscipline among workers even in relation to their unions.

3. Walter Galenson and Harvey Leibenstein, "Investment Criteria, Productivity and Economic Development", Quarterly Journal of Economics, Vol. LXIX, No. 3 (August 1955), pp. 343-370.
4. For illustration regarding indiscipline see Morris David Morris, "Labour Discipline, Trade Unions and the State in India", Journal of Political Economy, Vol. LXIII (August 1955), pp. 293-308.



These aspects could be tolerated in a colonial economy for political reasons, but trade unions in a free democratic country on its path of economic development can hardly afford such activities. One of their primary functions should now be to mitigate the feeling of distrust by the workers of the legally constituted Government and to assist it in implementing the development plans.

### V. Cushioning the Urban Shock

One of the disquieting features of the aftermath of the Second World War has been the rapid growth of such major cities as Bangkok, Delhi, and Djakarta. This trend towards increasing urbanization may be the result of many factors, such as refugee movements, the political importance of certain cities, the growth of commercial centers, pressure of population on land in rural areas, and industrialization.

The last factor is important from the point of view of trade unions. The main cause of overcrowding in cities is the large scale migration from rural areas, leading to urban concentration which is often linked with industrialization. The blending of the two populations with different cultures and outlook has been difficult often and has created certain political, economic, and social problems. Responsible governments have tried to slow down or canalize the flow of humanity on three grounds: the decisive influence of industrialization, the long-term advantages of economic expansion, and the immediate dangers of over-hasty development.<sup>5</sup> The general consensus, however, is against Government control, particularly when people leave their rural surroundings for economic living. Either the Government should provide for them at least a mean subsistence living in their villages, or it should solve the problems created by the migration in cities.

During the last few decades, there has been an appreciable increase in urbanization and growth of large cities. In India, for example, the percentage of urban population to the total increased from 9.4 in 1911 to 17.3 in 1951. This growth is due to natural increase (including absorption of adjacent areas) and rural-urban migration.<sup>6</sup> Natural increase seems to be the less effective factor, because of low birth rate and high death rate in the cities. On the other hand, the magnitude of the rural-urban migration can be illustrated by the fact that in 1931 more than a third of the inhabitants of India's major cities were found to have been born outside the city in which they lived; 75 per cent of Bombay's population and 41 per cent of Kanpur's was outborn.

Various factors have been responsible for this migration from rural to urban areas. The picture generally is one of a push from the land (because of pressure of population on land, plight of small landowners on account of fragmentation and sub-division, increase in the number of landless laborers, caste tyranny as evidenced from the fact that a majority of migrants are from lower

5. Pierre Wigny, "Migratory Movements in Underdeveloped Countries in the Course of Industrialization", International Labour Review, Vol. LXVIII, No. 1 (July 1953), pp. 1-13.

6. Kingsley Davis, The Population of India and Pakistan, Princeton, 1951, pp. 133-136.

classes, famines and crop failures) counterbalanced by the restraining pull from the land (arising out of socio-economic structure of the village, general immobility, joint family, effect of the caste system on occupational choice and social intercourse). In the struggle between city advantage and city repulsion, the former has won the battle, though it must be said to the credit of the villager that he moves to the city mainly under economic compulsion.

The immigrants from villages pose a special problem for trade unions. They create or aggravate various social problems like slums, sex-disparity, family questions, crime, delinquency, prostitution, gambling, alcoholism, unfair competition, etc. Their social adjustment in the settled population patterns must be smoothed, and the trade unions can assist the State in this task. One of the main ways in which the problem can be solved is the provision of industrial housing. It is possible for trade unions to float cooperative housing societies for their members and thus canalize the flow of immigrants.

#### VI. Psychological Readjustments

In a developing economy, factors like migration create certain important psychological problems, which are generally overlooked by trade unions and the State. Normally the persons who leave their villages for cities in search of employment are young and able-bodied men and their migration upsets the balance between the young and the old and between the sexes. The cream of the countryside is attracted towards the towns, leaving in the rural areas the children and the women, the old and the infirm. The impact of the migration at the other end is more disastrous. Most of the migrants are new to the cities and to the industries and they swell the unskilled sector of the industrial labor force.

They are at a disadvantage economically, socially, and psychologically, and neither the State nor the general public, neither the employers nor the trade unions take any steps to adjust them smoothly in their new life. Usually when a villager comes to town in search of a job, he stays with his friend, who was formerly in his village and who has secured a job and settled in the town. The villager, though married, comes alone with the hope of bringing his family after getting the job. Employment depends upon the demand for labor, which in turn rests on industrial policy. Unlike the case of plantations and mines, employment is not easy in industry and services, and often a person has to remain in the town without a job. The expensive city life and the village and family ties induce the migrant to go back; at the same time, the material comfort the glittering environment and his reluctance to admit defeat and go back to his family detain him in the city. If he does not get a job, he solves the problem by becoming an unsocial element, earning his living by doubtful means and enjoying the city life to the brim. Sometimes the villager succeeds in getting a job, often as a substitute worker. He starts at the lowest rung of the ladder, getting the minimum wage of an unskilled worker. The dearth of skilled labor remains, and we have somewhat of a paradox of abundance of labor and the shortage of the right type of labor.

Industrial labor in the sense of a stable, reliable, and disciplined group that has cut the umbilical cord connecting it with the land and has become suitable for utilization in factories is not abundant but extremely scarce in a backward country. The newcomers are normally taken in "marginal" occupations,

which require no skill and involve manual work, e.g., sweeping, cleaning, loading and unloading. In industrial job hierarchy, these jobs are supposed to be most degrading--those reserved for untouchables or menials and not for workers. As far as wages are concerned, these jobs are not far below those of unskilled workers.

The greatest psychological effect created on the mind of the migrant worker is the result of the new nature of work. Earlier, as an agricultural worker, he had not to abide by specific hours of work or by prescribed speed. He was practically free to determine the methods and pace of work, so long as he did the minimum amount of work. His relations with his landlord were cordial and often he was treated as a minor member of the family. When he becomes an industrial worker, he is expected to go to the factory at a particular time, work therein for a specified time with a minimum prescribed speed, abide by the various rules and regulations regarding work and safety, and strictly follow the factory discipline. Accustomed to work in a comparatively free atmosphere, the migrant worker is annoyed with the rules and regulations, in the framing of which he had no hand, and he is inclined to protest. His resentment turns to hostility in the impersonal atmosphere of the factory, and he comes to believe that the employer treats him no better than a machine, as merely a means of production.

The role of trade unions in these circumstances must be to help the villager adjust himself to the city life. A newcomer should not feel lost in the city. He should be assisted in his job hunt and later on he should feel accustomed to the labor discipline, demanded by modern industrialization and structuring.

With the assistance of other parties like the State and the employers, trade unions can successfully meet this demand of industrialism. They can find convenient tools in cooperative societies, training courses, and housing projects. A disciplined, stable, contented and loyal industrial force can then emerge, from which trade unions can draw their strength.

Economic development means change--changed methods of doing things; changed equipment and other resources with which to work; changed habits of consumption, saving, and investment; changed relationships to other people; changed availabilities of goods and services; and often changed attitudes, motivations, and ways of life.<sup>7</sup> The extent and rate of change depend on many factors, including the personality and cultural characteristics of the society; if these characteristics are unfavorable, economic development may take place slowly, if at all. The trade unions, as social organizations of workers, should try to prepare the workers for these inevitable changes on the path of economic growth. Some of the culture changes may not follow the Western pattern, or they may relate only indirectly to economic growth and modern technology.<sup>8</sup> In any case, it remains the responsibility of trade unions to cultivate among workers fine traits of personality and culture and noble qualities like honesty, integrity, and loyalty to the cause of unionism.

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Asoka Mehta

7. Samuel P. Hays, Jr., "Personality and Cultural Problems of Point IV", in The Progress of Underdeveloped Areas, Bert F. Hoselitz, ed., Chicago, 1952, pp. 206-207.

8. Morris E. Opler, "The Problem of Selective Culture Change", in ibid., pp. 126-134, gives many Indian examples of such cultural changes.

## CAPITAL-OUTPUT RATIOS IN ECONOMIC DEVELOPMENT

### I

How much capital must a country save or borrow abroad for domestic investment in order to attain a certain rate of economic growth? This is the question one wants to answer if one enquires into capital-output ratios and tries to measure them. On the face of it, the question should be easy to answer. There is plenty of statistical material giving information for various countries about the amount of investment undertaken over a certain period and about the growth of production that was associated with it or followed it a year or two later. I have taken a number of countries in various stages of development, and in order to obtain coefficients, I have related domestic capital formation during the years 1950-54 to the growth of production between 1951 and 1955; for some countries I had to take a slightly different period.

The evidence can be summed up very briefly:

A. If investment net of depreciation is taken as the measure of the growth of capital--that is, of increase in capacity other than that which may result from mere replacement through improved designs--and if, therefore, the (marginal) capital-output ratios computed on a net basis are regarded as the important ones, it appears that there is little or no correlation in that period between the size of these coefficients and either the level of development attained in the various countries or the rate of income growth achieved by them. The United States, United Kingdom, Germany, France, Italy, Greece, India, Burma, Ceylon, and Latin American countries all had very similar capital-output ratios, ranging between 2 and 2.5. Although there are some countries for which we get different values, the evidence suggests that if a country nowadays invests about 12% of its national income (net), production will probably rise by about 5%.

B. If gross investment is considered, the picture is somewhat different. Although the amount of net investment per unit of additional output was, as a rule, very similar for poor and rich countries, the low income countries and the countries with high growth rates almost invariably had lower gross coefficients: they needed less investment for a given increase in production, if one ignores depreciation costs (as usually conceived) and treats them as a mere accounting matter. This result is not surprising. One reason for it is that depreciation charges generally include a more generous allowance for obsolescence in the technically advanced countries than in the others, so that in the cases in which net coefficients are the same, the coefficients computed on a gross basis attain a higher value in the more advanced countries. Moreover, as one would expect, depreciation absorbed only a relatively small proportion of total capital formation in countries (whether advanced or not) where the rate of growth of investment was high or where investment was predominantly in structures and very durable forms of capital (as particularly in Greece during our period).



We included the figures for gross investment, for although what matters when one considers additions to the stock of capital is always net rather than gross investment, investment net of depreciation may actually be a less plausible measure of capital accumulation for some countries than for others: in rapidly growing economies, actual replacement of worn-out machines may be so small a fraction of depreciation that gross investment probably measures additions to the capital stock more accurately than net investment.

But we do not want to take this argument any further because we doubt whether any more conclusions--or any conclusions at all--should be drawn from these figures.

The main weakness of these data is that they cover too short a period. From one year to the next, marginal capital coefficients can be almost anything, and even averaging out over five years does not suffice to eliminate the more transient influences due, for instance, to changes in the degree of capacity utilization. In the present case the period covered includes years of reconstruction during which output in several countries increased faster than could be expected in more normal circumstances. It is true that one can often make at least an informal allowance for such transient influences; for instance, in the case of India one could say that the coefficient would have been somewhat lower than it actually was, had it not been for the large margin of excess capacity in almost all industries. After such corrections the figures become a little more serviceable if one wants to use them for prediction or programming. But they can still not tell us about the changes that will come from new development, or the other way around, they cannot tell us about the amount of capital that may be needed for bringing about the major changes over 10-15 years with which one is concerned in economic development.

## II

In programming work the following approach, or some variant of it, is often used to determine the capital requirements of a growing economy. Suppose that a certain increase in total production and aggregate consumption is taken as the tentative goal of a country's economic development over a stated period. Any such expansion will set up new demands for food and other consumer goods, for power, transport, buildings and building materials, and so on; and some of the additional demands will fall on imports. If one can estimate the size of the main streams of demand that will press on existing capacities as the economy is moving to the higher level, one might also obtain an idea of the capital cost of a program that would satisfy these demands. This presupposes that the investment requirements for expanding production in the principal sectors of the economy can be ascertained: they may be taken from engineering studies, from special evaluations ("how much finance is needed for building so many houses of a certain type?"), and sometimes also from the experience of other countries. There are of course problems of choice here which this type of analysis cannot settle; it would have to be widened to include, in particular, the life span of capital goods and a rate of interest. In actual practice, estimates of capital requirements (and of other variables) derived from such work reflect, rather than determine, the broad decisions taken on matters of policy and choice. The estimates may then serve as a check on the scale of a given program, or of repeated trial solutions, and may also be of value because of the light which is thrown on the economy in the process of making the estimates.

If the problem is considered in terms of change from one period to the next, estimates will be concerned in the first place with shifts in demand or changes in policy which can have a strong influence on the marginal ratio of capital to output: the ratio will rise so that an increment in aggregate production will require more investment in the period in question than before, if these shifts involve an increase in the relative weight of industries with heavy capital requirements. These include, in particular, the public utilities, public works, and housing which employ or represent very durable capital containing a large construction element; they always have high capital coefficients compared with the national average--in the utility field one generally finds coefficients ranging from 6 to 10, or even more--and between them they may account for 45-65% of total capital formation. The scale and composition of these investments is in large part a matter of policy, and they are often planned and built ahead of demand with the idea of creating expansion. Insofar as these expenditures represent an investment in the overhead of a modern economy, they tend to absorb a higher proportion of total capital formation in early periods of development, or in early phases of a development program, than later; the effect of this sequence on aggregate capital coefficients is historically well established. We find this phasing in development programs such as the Italian, where the time-distribution of investment by broad sectors is estimated over a period of ten years.

Shifts between agriculture and industry also have a fairly regular and well known pattern in the course of economic development. This influence on aggregate capital coefficients is less certain, but in low-income peasant countries which start factory industries, the effect will be to raise investment requirements per increment of aggregate output because factories on the average work with higher capital coefficients than farms do in such countries. (With plantations the situation may be different). We can see this happening in present-day India. The second Indian Plan anticipates a shift, not so much into the overhead investments (although the railway component, with an estimated capital coefficient of 8, has been sharply raised), but into industry, while the share of agriculture in output and investment is declining. Insofar as this shift is in favor of cottage industries, the effect actually is to lower the aggregate capital coefficient: in the Indian household enterprises and village industries capital coefficients are well below unity, while for agriculture (including irrigation and flood control) the coefficient is about unity, if the non-monetary investment of the peasants is disregarded. The major stress in the Indian plan, however, is on the expansion of factory industries and within the factory sector on industries such as cement, steel, heavy chemicals, sugar refining and paper, for several of which engineering studies have indicated capital-output ratios of 3 to 4 for new plants. As a result of this emphasis on relatively heavy industries, the sector coefficient for modern industry has been revised upwards from 1.6, which was the actual outcome in the period of the first plan, to an estimated 2.2; and the net effect of all these shifts (and of some others) is an increase in the aggregate capital coefficient by 3 or 4 decimal points--an estimate which we quote not because it will necessarily come true, but because it illustrates the influences set up by the present system of priorities.

An analysis of changes in aggregate capital-output ratios which confines itself to tracing inter-industry or inter-sectoral shifts is necessarily bounded by a fairly restricted time horizon. Over longer periods there are many more variables as industry coefficients change and as differentials between industries



alter with regard to their ratios of factors to output. As economic development proceeds, labor skills improve, economies of scale are experienced at particular stages of growth, and technical knowledge advances. In consequence, once the capital stock has been built up to a certain size and economic organization is better adjusted to the requirements of a growing economy, the continuing increase in capital per head may be associated with a non-rising or even falling capital-output ratio. However, such changes which raise the physical yield of capital (as well as of other inputs) will occur in different industries at different times and will transform some industries more than others. In the past, capital-saving innovations appear to have been of greater importance in industries with high capital coefficients (including the public utilities, where, of course, economies of scale also play a very large role) than in industries with low coefficients. Among the industries that have lagged behind in technical progress is the building industry, a fact which we have to mention because of its direct bearing on changes in aggregate capital-output ratios: these changes depend, among other things, on how fast efficiency improves in the investment sector, compared with efficiency gains in consumption industries. But such historical experience does not provide a safe basis for projections or forecasts. Industry rates of change in productivity are unpredictable and can be brought into a programming analysis only as actual information about them becomes available from industry studies or from other evidence.

In another context, we will come back again to changes over time, but now we turn to a comparison of capital coefficients between countries. All the factors which in a given area make for change now appear as determinants of differences. To illustrate this and to introduce a number of other determinants, we will take the two programs already referred to: the Indian and the Italian development programs.

The marginal capital-output ratios on which these two programs are based--or at which they have arrived--are of a quite different order. In the Second Indian Plan, which aims at an annual growth rate of income of 4.5% over five years, the rate of fixed investment is 9.5% on the average for the period, which implies a marginal capital coefficient of 2.1 (disregarding inventory accumulation and non-monetary investment). The corresponding ratio in the Italian program is 3.6 (computed on a synchronous basis) for an average growth rate of 5% per year over ten years. Whether the actual outcome will conform to these estimates is of course uncertain and does not concern us here; our question is how this wide difference in the two capital coefficients--3.6 as against 2.1--has come about in the estimates.

A. A part of the difference appears to be due to the difference in the decisions or anticipations regarding the spread of investments, and here the main difference is in the share of housing. In the Italian plan housing accounts for about 22% of total fixed investment as against 12 or 13% in India (the precise figure for new residential construction in India is difficult to establish). What India saves on housing--and also on various public works and miscellaneous services--goes into proportionately higher allocations to public utilities, mining and industry, and agriculture, i.e., into investments which, in a sense, are more productive. Taking mining, industry, and agriculture alone, they absorb in the Indian plan about 43% of fixed investment, while in Italy they receive 35%.

In view of this difference in the weight of productive investment and housing in the two plans, one might try to assess the separate importance of

housing as a determinant of the aggregate capital-output ratio. Suppose India doubled her investment in housing, with an equivalent increase in the amount of total investment. The share of housing would then be about the same as in Italy, and if we treat housing as a welfare item that does not produce an additional income, the capital coefficient would work out at 2.4.

Of course, this statistical exercise does not explain very much. For a more informative comparison one would need data (1) on the amount of housing construction not shown in the national accounts, particularly in the rural economy of India; and (2) on building costs, which may be lower in India, in which case a given money expenditure would represent more houses built than in Italy. On both counts, India's relative housing effort is probably higher than appears in a superficial comparison. There is, however, no doubt that the stock of urban housing (which is the main problem) is very small in relation to urban population in India and that the additions to the stock do not at present keep pace with growing needs. At the same time an even greater proportion of these needs than in Italy must relate to people who could not afford to pay for better housing. The whole matter is clearly one of public policy and priorities as well as of level of income. In our comparison of capital coefficients, however, it does not seem to be a very decisive factor.

B. Much more important, and indeed decisive, is the difference in the role and the technical characteristics of agriculture in the two countries. In India over a third of the increase in income is expected to come from agriculture, although its share in output is falling. The demand for food has a high income elasticity--around 8 for all food items together--so that the growth of income makes heavy claims on agriculture. But for the time being these claims can be met at a relatively small capital cost: as mentioned before, the marginal capital coefficient in Indian agriculture is only about 1, whereas in Italy it is nearly 6. For in Italy the best and most easily accessible land is already in intensive cultivation so that the further expansion in agriculture demands costly investments in land improvements; and although agriculture in Italy is not expected to contribute more than 8% to the growth of income over the 10 years, the share of investment going to agriculture is not very substantially lower than in India--14% instead of 18%. Even allowing for the possibility that some of these investments will give their full fruit only after the plan period, the difference is enormous. In quantitative terms one could describe it as follows: if for an increment of output India had to invest in agriculture as much as Italy, the aggregate capital coefficient would be 3.8 instead of 2.1 on the basis of the present distribution of output, while on the basis of the present distribution of investment it would be 3.

The difference in the position of agriculture in the two countries is closely connected with the degree of development which enters as a determinant both into the conditions of demand for food and into supply conditions. But, of course, the cost of improving and expanding land resources is not merely a function of the degree of development. It depends on facts of geo-chemistry on the texture of the soil, and other natural factors, so that land that is very poor in its natural state requires expensive investments for improvement. In spite of foreign trade, which offers an escape from poverty of natural resources, this factor never quite ceases to have some importance. There is some rough evidence that countries with poor natural resources generally have higher investment requirements for similar growth rates than countries in which natural resources are more plentiful or more easily accessible. Japan is perhaps

a case in point. On the basis of Ito's and Yamada's statistical estimates, the average ratio of capital to output in Japan was 4.3 for the period 1913-1938, while the marginal ratio was about 4; and it is now still near this level.<sup>1</sup> These are relatively high ratios, considering the large role and labor-intensive character of Japan's agriculture and her small enterprises, as well as the fact that Japan never seems to have invested in housing as much as most other countries. The explanation may well be the high cost of natural resource development in Japan, although we are not able to substantiate this.

Next consider industry coefficients in different countries. Going back to the comparison between India and Italy, the estimated coefficients for industry as a whole, including building, the handicrafts, and factory establishments, are very similar and well below 2 in both countries. In factory industry, the Indian plan has a stronger bias towards industries which are heavy users of capital, but this is offset by the fact that cottage industries make a proportionately larger contribution to the increase in industrial production than in Italy, although their weight within industry is slowly declining.

It is worth adding parenthetically that capital-heavy industries are not identical with investment goods industries. Their common characteristic is the continuity of process or product--whether consumer good or producer good--which makes it profitable for these industries (or more profitable for them than for others) to use long-lived capital goods and to develop the corresponding techniques involving high capital-output ratios. They include steel and other producer goods in universal use, but also various consumer goods industries; they do not include most of the modern machine industries, nor building, which is a very important investment industry. The growth of these heavy (continuous process) industries is related to the degree of development only insofar as their establishment--if they are to be set up as manufactures for the home market--presupposes that the economy has a certain minimum size so as to be able to support at least one efficient plant. But for most industries this size requirement is moderate so that one or several of these industries may be established relatively early. Their high capital requirements would be a factor telling against them if lower capital costs are incurred in expanding real foreign exchange earnings with a view to importing the commodities which these industries would produce domestically.<sup>2</sup>

Finally, how do capital-output ratios compare in industries or enterprises producing more or less identical products in countries differing in degree of economic development? What evidence there is on this point suggests that the physical yield of capital is very similar in comparable industries in different countries and is usually not lower--or not much lower--in underdeveloped countries than in advanced countries. This similarity appears to be the result of opposing influences, some of which tend to make the capital-output ratio higher while others tend to make it lower in the underdeveloped countries, the various influences more or less offsetting each other. On the one hand, plant and equipment come from the industrial countries and are of the same type as are

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1. Cf. Yuzo Yamada, "Notes on Income Growth and the Rate of Saving in Japan", Income and Wealth, Series V, Simon Kuznets, ed., London, 1955.

2. On this point and related matters see Hollis B. Chenery, The Structure and Growth of the Italian Economy, Rome, 1953.

in use there, but the extra cost arising from the need to import this equipment, and frequently also inferior production control and maintenance, tend to make for higher capital-output ratios. On the other hand, the auxiliary processes such as materials handling are generally non-mechanized, and even the process equipment is often operated by more people than would be needed in the advanced countries. As a result the capital-labor ratio as well as labor productivity (the labor-output ratio) are almost invariably considerably lower in the underdeveloped countries, but there is much less difference in the capital-output ratio if one takes all operations together.

If this picture is broadly correct, it implies that enterprises in underdeveloped countries quite logically place the main emphasis on getting the highest possible results from their expensive equipment rather than from their cheap labor; and also that they substitute labor for machines where it can be done. One must not take it for granted, of course, that suitable industrial labor at the plant site is always cheap in these countries; nor is it the rule in manufacturing that by using more common labor instead of machines more or less the same time-flow, quality and precision of output are obtainable as from machine work. But where labor and capital can most readily be treated as substitutes as in many auxiliary processes, the evidence is that underdeveloped countries do in fact mainly rely on non-mechanized work. The scope for such substitution is much larger outside manufacturing, however, particularly in roadmaking and excavation work, although for technical reasons a certain degree of mechanization is often unavoidable.<sup>3</sup>

### III

In current discussions the question is often raised whether marginal capital-output ratios in underdeveloped countries are likely to be higher or lower than in the advanced countries. In view of the numerous factors involved, which I have discussed in the preceding analysis, it hardly seems possible to give a definite answer.

The presumption often found in the literature that capital coefficients will be higher in underdeveloped countries rests on two main arguments: (1) labor and management are less efficient in using capital goods in these countries, and (2) for lack of external economies, in particular, they do not operate under the law of increasing returns which in the more advanced countries applies not only to the material factors of production but to technical knowledge itself. These arguments are very strong. Another less important one is that insofar as these countries have to use imported equipment, they have to incur transport costs, etc., which add to the value of their capital requirements.

But there are quite a number of offsets: the lower efficiency of labor may be offset by the more lavish use of labor; the higher cost of imported equipment may be more than compensated in some underdeveloped countries--but not in all--by their comparative advantage in the building industry, which constructs the bulk of the capital stock. If one regards the importation of new techniques

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3. Cf. Government of India, Ministry of Irrigation and Power, *Report of the Construction Plant and Machinery Committee*, New Delhi, 1954, particularly Ch. XV on "Manual Labour versus Machinery".



as innovations, the rate of innovation is likely to be high in these countries, once they have entered a period of rapid growth. Moreover, a larger (though declining) part of increasing production, than in advanced countries, comes from producers using very little capital; reserves that are quite specific to these countries are activated as the degree of commercialization increases. There are no doubt other factors, but there is no point in adding to this list: it will not enable us to reach a firm conclusion.

The question can be and is often put differently. It is certain that in a process of economic growth there is always an early period during which successive increments in aggregate output demand more investment than corresponds to the average yield of the capital stock already in use: the capital-output ratio moves up from its pre-industrial base. But how far will the increase go? In some Western countries for which there are records going back to the 1860's, economic development was associated with a gradual increase in the average ratio of capital to output to 3.5 or 4; the marginal coefficients, averaged out over a decade, showed no definite trend; they fluctuated above the average ratio. If one takes these historical ratios as a yardstick, one can say with a fair degree of confidence that the capital cost of development is lower nowadays than it was half a century ago. These historical ratios might be regarded under present-day conditions as an upper limit, but, except in countries very poor in natural resources, the coefficients are likely to be somewhat lower.<sup>4</sup>

Of course, this is merely another way of saying that countries trying to modernize their economies have the benefit of the advances in knowledge that have occurred since the beginning of this century. These benefits are most obvious where they can be realized with only moderate amounts of investment or, better still, without additional investment (e.g., better seeds). But there is no denying that, more often than not, the modern technologies which embody an advance in knowledge are costly to install and that they have more or less strong labor-saving effects (among others). Although this raises awkward problems, the fact remains--and this is all we are saying here--that insofar as these techniques can be used in the poorer countries, these countries participate fully or partly in the progress which, in the course of years, has increased the efficiency of these techniques relatively to their cost.

Nor is it without relevance that populations are increasing faster in most underdeveloped countries--or that accumulated labor reserves are larger--than in 19th century Western Europe. For one generally expects relatively high rates of output growth for a given amount of capital accumulation when the increase in capital is associated with a relatively large increase in labor. This argument is implicit in what I said earlier; it is particularly strong for periods when the basic investments are made, if at the same time the productivity of agriculture can be raised at small capital cost, for this makes the recruiting of labor for construction work and its tooling up for industrial work easier and less expensive. Where conditions in agriculture are less favorable, the argument loses much of its force.

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4. The statement that under present-day conditions the capital cost of development is likely to be lower in most countries than it was fifty years ago is not very informative or helpful, however, and we do not attach much importance to it. Serious estimates of capital-output ratios can only be made on the basis of local studies.

## SAVINGS AND ECONOMIC GROWTH IN JAPAN

### I. Introduction

The main features of Japan's capital accumulation throughout the past several decades have been (a) relatively small amount of foreign capital import; (b) high rate of voluntary savings; (c) non-monetary capital formation in agriculture and small scale industries; and (d) inflationary credit creation by the government and banks.

The long-term tendency of Japan's economic growth as compared with several other countries of the world is shown in Table I.

Table I. Comparison of Annual Growth Rates

|                    | National Income       |                        | National Income per<br>capital of gainfully employed |           |
|--------------------|-----------------------|------------------------|--|-----------|
|                    | Period I <sup>a</sup> | Period II <sup>a</sup> | Period I   | Period II |
|                    | %                     | %                      | %  | %         |
| Japan <sup>b</sup> | 3.8                   | 4.4                    | 2.9  | 3.7       |
| Japan <sup>c</sup> | (2.7)                 | (5.7)                  | (1.4)  | (4.8)     |
| United States      | 3.9                   | 4.3                    | 1.3  | 2.7       |
| United Kingdom     | 1.9                   | 1.9                    | 0.7  | 1.3       |
| France             | 1.1                   | 0.9                    | 0.5  | 0.7       |
| Belgium            |                       | 1.1                    |  | 0.7       |
| Netherlands        |                       | 1.8                    |  | 0.2       |
| Switzerland        |                       | 1.6                    |  | 1.1       |
| Norway             |                       | 1.9                    |  | 1.1       |
| Denmark            |                       | 2.1                    |  | 0.1       |
| Sweden             | 3.3                   | 4.0                    | 1.0  | 1.3       |
| Australia          |                       | 2.2                    |  | 0.5       |
| New Zealand        |                       | 2.6                    |  | 1.2       |

a. Period I: around 1878-82—1908-12; Period II: around 1908-12—1938-42.

b. Tsuru and Ohkawa's estimate.

c. C. Clark's estimate

Sources: S. Tsuru and K. Ohkawa, Nippon Keizai no Bunseki (Analysis of Japanese Economy), Tokyo, 1953, p. 40.

Colin Clark, The Conditions of Economic Progress, London, 1951, passim.

According to M. Ito's estimate<sup>1</sup> for the period 1913-35, the average annual rate of growth of national income was about 4.5%, with a capital output ratio of 4.2, and a rate of savings of 19% of national income. Although no adequate

1. In Tsuru and Ohkawa, eds., op. cit., p. 135. [See Table I.]

statistics are available for the period prior to 1913, it is assumed that the rate of savings was somewhat lower.

A rate of savings of nearly 20% of national income is a relatively high figure compared with that of other countries, but not extraordinarily high. For example, according to C. Clark's estimate of rates of savings of the United Kingdom in 1860 and Germany from 1897 to 1909, they were 17.7% and 17.3% respectively. Furthermore, according to Kuznets' estimate, the rate of savings of the United States was 16.2% for the period 1884-1898. However, one of the remarkable features of Japan's economic development is the fact that the relatively high rate of savings, and accordingly that of growth, was maintained throughout several decades.

The causes for the high rate of savings have been given by the author of this article in an article in the India Quarterly.<sup>2</sup> They are as follows:

A. The rural areas under the pressure of chronic over-population could supply labor power almost without limit to the industries at very cheap wages. This made it possible for industries to maintain a high rate of capital accumulation.

B. The existence of a semi-feudalistic social and political structure, which restricted the mobility of labor and kept wages relatively low.

C. The introduction of advanced techniques and the encouragement of technical improvements both by the Government and private enterprise, which resulted in a rapid increase of productivity in industries without a corresponding rise in wages which in turn made the profit margin high for industries.

D. A high rate of savings was encouraged by the establishment of a well organized and widely spread government postal savings system.

In addition to these factors, others, such as the relative political stability and rapid increase of population (contrary to the views of some economists) may be counted as causes of high rate of capital accumulation in Japan. Incidentally, some of the causes given above do not apply any more to post-war Japan, because of the various reforms introduced by the occupation forces as well as by the Japanese themselves. The fact that the high rate of savings has continued into the post-war period deserves careful study, and some of the post-war development will be dealt with in the latter part of this article.

## II. Mechanism of Capital Accumulation in Pre-War Japan

The mechanism of capital accumulation in pre-war Japan can be stated briefly.

### A. Voluntary savings and financial institutions

Voluntary savings in Japan were encouraged by the development of financial institutions which provided facilities for savings. Postal savings played a very important role, particularly in the early period of modernization. As banks

2. Saburo Okita, "Japan and Asia's Economic Development", India Quarterly, October-December 1951.

expanded in number and in their scope of activities, the relative importance of postal savings gradually declined, but even in 1936 the deposits outstanding of the postal savings system was about one-quarter of that of all ordinary banks. While the ratio of total deposits outstanding of banks and the postal system was only 4 per cent of national income in 1893, it rose to 50 per cent in 1916 and to 100 per cent in 1931. This indicates the extent of institutionalization of savings in Japan.

With the progress of the economy, various other forms of savings developed, such as insurance, trust, equity investment, etc. But even as late as 1936, bank deposits were the major source of savings. These deposits were largely in the form of time deposits.

Hence the banks played a very important role in providing long-term capital for industries, and this was one of the outstanding features of Japan's financial structure. There were two more important features, one being the high dependency of banks upon the central bank, and the other being the close relationship between government finance and banking.

As banks collected large amounts of long-term deposits from the public (as of the end of 1936, time deposits accounted for 60 per cent of the total deposits of all ordinary banks), they discharged a dual function, as distinct from the banks in other advanced countries. They financed short-term commercial, as well as long-term equipment fund requirements of industries. Thus the prestige of banks in Japan was very high, and their influence over the entire economy was substantial. It is also worth noting that the major part of the banking activities were concentrated in a few big banks. While there were 424 ordinary banks in Japan as of the end of 1936, the deposits outstanding of 6 major banks (Mitsubishi, Fuji, Mitsui, Daiichi, Sumitomo, and Sanwa) accounted for 53 per cent of the total of all ordinary banks.

Investments in stocks or corporative bonds by the public were not very large. Although banks were generally reluctant to participate in issuing or subscribing to stocks, they extended loans taking stocks as collateral. Stocks of well-established companies affiliated with the Zaibatsu, the big family combines, were purchased and held by holding companies or affiliated companies with funds supplied from affiliated banks. The bond market was not well developed. Although the stock market made early progress, there was a strong tendency for the stock exchanges to be utilized by speculators rather than investors. Under these circumstances, enterprises had to depend heavily on long-term loans from the banks.

There was another additional factor which encouraged savings in the form of bank deposits rather than direct securities investment, i.e., the fact that the taxation system in pre-war Japan favored bank deposits by applying a fixed tax rate to the interest of bank deposits, whereas a progressive rate was applied to dividend income.

Since banks could not collect sufficient savings from the public to meet the needs of rapidly expanding industries, they had to borrow from the Bank of Japan to supplement their resources. Thus the Bank of Japan loans were channeled directly to financial institutions with Government bonds, stocks, corporate bonds, and other securities as collateral.



As the government took the lead in promoting economic development from the Meiji era, its relation to banking was naturally very close. This was reflected in the establishment of special banks for supplying long-term funds, use of the Deposit Bureau of the Ministry of Finance (the major source of the Bureau's funds were postal savings) for subscribing to central and local government bonds and supplying funds for various special corporations established by the government. Thus the government itself was a large banking institution, and it exercised big influence upon both money and capital market.

All these features of the financial system reflected the basic characteristics of Japan's economic and social structure, i. e.; (a) coexistence of modern and feudal sectors in the economy; (b) concentration of wealth in the hands of a relatively small group known as the Zaibatsu; (c) government leadership in promoting economic development; and (d) the need for rapid economic development to catch up with other advanced countries as quickly as possible.

#### B. Savings through government finance and inflation

When an underdeveloped country with a predominantly agricultural economy moves toward industrialization, the necessary capital for such development, particularly in the early period, must come mainly from agriculture. In the early Meiji period, the feudalistic tributary payments system was replaced by a land-ownership farm-rent and land tax payments system. Landowners accumulated wealth by receiving farm-rent from the tenants and, in turn, invested their money in various enterprises or deposited their money with banks which channeled savings into industries.

Another way of transferring capital from agriculture to industries was the heavy taxation of land and the relatively light taxation of industries. For establishing new industries, the government often took such measures as subsidization, tax exemption, guarantee of dividend payments, etc. In the early years of modernization, land tax accounted for more than 90 per cent of the central government's tax revenue, and it took forty years before this ratio was reduced to less than 10 per cent.

On the other hand, personal income tax, which was introduced in 1887, increased as a percentage of total tax revenue from 2 per cent in 1895 to 7.2 per cent in 1914 and 18.9 per cent in 1935.

Other major sources of revenue, i. e., other than land and income tax, were the liquor tax and profits from government monopolies (tobacco, salt, and camphor).

Thus, agriculture bore a heavy burden for the sake of industrialization, particularly during the early period. Only a relatively small share of the accumulated capital was returned to agriculture in the form of investments in irrigation, flood control, land improvement, and reclamation. This process was necessary for developing industries, but in Japan it had gone a little too far, and after secondary and tertiary industries were fairly well developed, agriculture was placed in a relatively unfavorable position. According to an estimate made by the Economic Planning Board, the living standard of farmers as compared with that of factory workers was some 30 per cent lower in 1934-36.

It is worth noting that although the Government participated strongly and took the leadership in the process of economic development, its ownership of industries was not very large, and the major part of industrial assets was privately owned. It is true that the government started some of the industries, but most of them were sold to private business when they became more or less established. The only exceptions were the railways. They were started as private enterprises, and later the major railway lines were nationalized. The electric power industry was initiated as private enterprise and has been in the hands of private business ever since, though for some time during the last war it was under strong government control. The iron and steel industry was initially established by the government, and state ownership continued until the early 1930's, when it was reorganized into a private company. But private steel mills existed side by side with the government plants.

Thus, savings through government finance by such measures as the creation of a surplus of revenue on current account and the making of profits from government enterprises were not very important. Public works such as flood control, irrigation, road and harbor construction were financed by the government out of current revenue, and to that extent the government directly contributed to capital formation. Because of the frequent natural calamities, such as earthquakes, typhoons, or floods, expenditures to remedy their effects were for the most part maintenance costs for the Japanese economy.

Thus, the direct contribution of government finance to capital formation was rather limited, and its major contributions were through indirect measures. First of all, maintenance of political stability provided a broad basis for savings. Without the feeling of security, people would not make voluntary savings. The aggressive attitude of the leaders of the Meiji Government toward spreading education, particularly primary education, also contributed toward building a foundation for economic development. Primary school education was established by the Meiji Government as one of the three major duties of people, together with tax payment and military service.

The other important role of the government in promoting capital accumulation was to utilize banking institutions for creating credit. In most underdeveloped countries, domestic voluntary savings are rather scarce, and if the amount of new investment is to be confined strictly to the amount of savings collected by the financial institutions or by the Government, not much could be done. Throughout the course of economic development, Japan was always short of capital, and the government did not hesitate to take every possible measure to augment the supply of credit.

With the establishment of the Bank of Japan in 1882, it was decided by the government that the bank notes issued by the National Banks, which had been established earlier, were to be withdrawn in the course of twenty years, and those banks were to be transformed into ordinary commercial banks. However, since voluntary savings in the form of bank deposits were rather scarce, banks were compelled to borrow from the Bank of Japan as they withdrew their notes from circulation. This was the origin of the high dependency of banks upon the Bank of Japan and the so-called "overdraft"<sup>3</sup> of the banks, which became

3. The term refers to an excess of loans and discounts over deposits, capital stock, and reserves, the deficit being covered mainly by borrowings from the Bank of Japan.

traditional in Japan's banking system. Basically, this dependency was due to the shortage of voluntary savings collected by banks as compared with the demand for credit of enterprises which were developing rapidly.

This history indicates that in the early state of Japan's modernization, government and banks first created money and credit, which stimulated the establishment of various enterprises, and then later collected private savings in money form to augment institutional savings. This process was almost the reverse of that of the development of banking institutions in Western countries. But for a country like Japan, which started the process of modernization much later than other capitalistic countries and was eager to catch up with the advanced countries in the shortest possible time, such a process of development may be considered almost inevitable. In the 1930's, when heavy industries were forcibly developed to meet military requirements, the government relied primarily on the credit creating power of the central bank as a means of finance. Although the method of financing adopted during this time was again inflationary, the industrial structure was greatly transformed in the course of ten years from 1930 to 1940. For example, the ratio of light to heavy industries in terms of total value of production was 4:6 in 1930, whereas it was 6:4 in 1940; and the total output of the manufacturing industry was more than doubled during that period.

Looking back over the whole course of Japan's economic development during the past several decades, one may find that the inflationary measures for capital formation have contributed, on the whole, to rapid economic growth, though they were accompanied by various ill effects. Moderate, intermittent inflation, without destroying the belief in the basic soundness of the currency and therefore without damaging the savings habits of the people, may have been one of the outstanding features of the pre-war Japanese economy.

### C. Effects of foreign capital inflow

Japan is often cited as one of the rare cases of a backward economy developing rapidly without any significant foreign capital inflow. In the history of Japan's economic development, the introduction of Western techniques played a very important role. But this was not necessarily accompanied with the importation of foreign capital. Up to the outbreak of the Sino-Japanese war of 1894-95, there was practically no significant amount of foreign investments in Japan. However, during the period 1896-1913, fairly large borrowings from abroad, amounting to almost 2 billion yen, were successfully undertaken. (This amount is about 2.5 per cent of Japan's total national income through that period.) These borrowings were necessitated chiefly because of the expenditures required for the conduct of the wars with China (1894-95) and Russia (1904-05). With these loans the government was able to meet the war requirements without undue restraints on business investments, which were booming with the stimulation of the victorious wars. Moreover, since these borrowings were mostly by government and portfolio loans from private investors abroad, Japan was able to avoid foreign control over her domestic economy, which might have occurred if the loans had been inter-government borrowings or foreign equity investments.

World War I brought windfall profits to Japan, and she was able to accumulate a substantial sum of foreign exchange. It was spent, however, in the course of the following ten years. On the other hand, with an expanded sphere of influence, Japan started investing abroad, and it is estimated that by 1934 she was already in a creditor position on capital account.

On the whole, it may be concluded that the inflow of foreign capital as such did little to make up for the shortage of domestic capital supply in the pre-war development of Japan's economy.

### III. Post-War Development

Far-reaching changes have taken place in the political, social, and economic setup of Japan as the result of the defeat in World War II and the subsequent occupation by the Allied Forces. Some of those changes are: loss of overseas territories; encouragement of the labor movement which served to increase labor's share in the distribution of income;<sup>4</sup> land reform abolishing big and medium land ownership which contributing towards raising the living standard of the farmers;<sup>5</sup> dissolution of the Zaibatsu to decentralize economic power; introduction of a steeply progressive income tax schedule; development of social security measures;<sup>6</sup> a growing desire by the average people for better living; and so forth. One may be inclined to feel that all these changes have been conducive to lowering the rate of savings in the post-war years. Statistics indicate, however, that the high propensity to save of the Japanese economy has continued into the post-war years and that the rate of savings is even higher than pre-war.

Comparing pre-war and post-war figures, one will notice that capital formation in the government sector has more than doubled, and that in the private sector it is also somewhat higher in the post-war period. Reflecting this high rate of capital formation, the rate of economic growth is also remarkably high in the post-war years. The average rate of increase of national income from 1950 through 1955 was 8.3 per cent annually, whereas the rate for the period

#### 4. National income by distributive shares is as follows:

|  | 1934-36 | Fiscal years<br>1951-55 |
|--|---------|-------------------------|
| Compensation of employees                          | 38.9    | 46.6                    |
| Proprietors' income                                | 31.3    | 41.0                    |
| Rental income of persons                           | 9.1     | 1.1                     |
| Personal interest income                           | 9.2     | 1.9                     |
| Corporate profits                                  | 8.7     | 9.6                     |
| Surplus of Government enterprises, etc.            | 2.9     | 0.9                     |
| Net income from overseas                           | 0       | -0.3                    |
| Less: Interest on public debt and<br>consumer debt | -       | -0.8                    |
| Total (National Income)                            | 100     | 100                     |

#### 5. Average family expenditures in 1955 as compared with pre-war (1934-36 = 100) is as follows:

|               |       |
|---------------|-------|
| Urban (Tokyo) | 106.5 |
| Rural Area    | 128.1 |
| Whole Nation  | 115.1 |

#### 6. Social security expenditures accounted for 13 per cent of the 1956 budget but only 2 per cent of the 1934 budget.



Table II. Rate of Gross Capital Formation  
(Gross capital formation/GNP)

|                             | Domestic |            | Subtotal | Surplus of<br>Overseas<br>Current<br>Account | Total  |
|-----------------------------|----------|------------|----------|--|--------|
|                             | Private  | Government |          |  |        |
| <u>Pre-war<sup>a</sup></u>  |          |            |          |  |        |
| 1930-34                     | 9.2      | 3.2        | 12.4     | 0.3  | 12.7   |
| (1934-36) <sup>b</sup>      | (15.8)   | (3.2)      | (19.0)   | (0.1)  | (19.1) |
| 1935-39                     | 19.5     | 3.3        | 22.8     | 1.0  | 23.8   |
| <u>Post-war<sup>a</sup></u> |          |            |          |  |        |
| 1946-50                     | 17.1     | 8.2        | 25.3     | -2.6   | 22.7   |
| 1951-55                     | 18.9     | 8.2        | 27.1     | 1.7  | 28.8   |

- a. Figures for the post-war period are based on fiscal years (April-March), and for the pre-war period on calendar years.
- b. For the pre-war period, 1934-36 is relatively normal, since 1930-34 includes depression years and 1935-39 includes war years beginning in 1937.

1930-40 was about 3 per cent. High post-war rates of savings and economic growth may be attributed in part to the process of recovery from the extremely low level right after the War, but this does not suffice to explain the continuation of high rates more than ten years after the end of the War. It is estimated that during 1956 national income increased by about 11 per cent in real terms over 1955 and the ratio of gross capital formation to gross national product was about 30 per cent.

In order to analyze the causes for the post-war increase in the rate of capital formation, a breakdown of gross capital formation for pre-war and post-war years is given in Table III.

Table III. Comparison of Gross Capital Formation

|                                | 1934-36             | 1951-55 |
|--------------------------------|---------------------|---------|
|                                | (Percentage of GNP) |         |
| Personal residence             | 1.4                 | 1.3     |
| Durable equipment <sup>a</sup> | 13.1                | 19.0    |
| Private                        | 9.9                 | 11.4    |
| Government                     | 3.2                 | 7.6     |
| Changes in inventories         | 4.5                 | 6.8     |
| Private                        | 4.5                 | 6.2     |
| Government                     | -                   | 0.6     |
| Sub-total                      | 19.0                | 27.1    |
| Overseas surplus               | 0.1                 | 1.7     |
| Total                          | 19.1                | 28.8    |

- a. This includes buildings and structures other than personal residence.
- Source: National income statistics compiled by the Economic Planning Board.

Looking at Table III, one will notice a sharp rise in government investment. This rise in government investment may be explained as follows: (1) defense expenditures which accounted for 5-7 per cent of national income in pre-war budgets were reduced to about 2 per cent of national income in post-war budgets, and a considerable portion of this economy in defense expenditures is now channeled into investment in basic facilities; and (2) although the ratios of government expenditures to national income in recent years have been similar to those of pre-war years, post-war tax payments as percentages of national income have been considerably higher,<sup>7</sup> because in pre-war budgets a substantial portion of the government revenue was obtained from bond issues,<sup>8</sup> whereas in recent budgets there has been a balance between revenues and expenditures, and bond issues have been avoided. Thus savings from tax revenues have been larger in post-war years.

It is worth noticing that in spite of the heavier tax burden in post-war years the propensity to save of the people remains high. The average propensity to save (as a percentage of personal disposable income) was 15.6 in 1951-55, whereas it was 15.2 in 1934-36.

There have been some changes in the financial structure after the War, but the basic features of financial institutions did not change very much. For example, banks still supply large amounts of equipment capital to industries, banks are still heavily dependent upon the Bank of Japan and the "overdraft" position of banks has been conspicuous, and the Government Deposit Bureau, now called the Trust Fund Bureau, is still playing an important role. Thus, financial institutions have remained relatively intact despite the occupation, in contrast to education, agriculture, labor, etc.

In connection with the high rate of post-war capital formation and economic growth, a recent trend of population growth, particularly that of persons of working age, is worth mentioning.

Because of the combined effect of a sharply reduced death rate and the high birth rate in the past, the number of people in the working age group has increased enormously in recent years.

The annual increase in working age population in post-war 1951-65 is more than double that of pre-war 1920-35, and this sharp increase in the working age population exerts upward pressures on economic activity, with a resulting high rate of economic growth. Thus, in the case of Japan, it seems that the rapid increase of population may not have been the cause of a low rate of savings and economic growth, but rather the contrary. For the same reason, the rate of savings and economic growth may decline after 1965, when a sharp fall in the rate of increase of the working age population is expected to start.

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| 7.      | National tax | Local tax | Total |
|---------|--------------|-----------|-------|
| 1934-36 | 8.5          | 4.4       | 12.9  |
| 1953-55 | 15.1         | 5.8       | 20.9  |

8. Nearly one-third of the General Account revenue came from the proceeds of bond issues in 1934-36 budgets.

Table IV. Average Annual Increase of Population  
and Working Age Group

|           | <u>Total</u><br><u>Population</u> | <u>Working Age</u><br><u>Group (15-59)</u> |
|-----------|-----------------------------------|--|
| 1920-1935 | 890,000                           | 510,000                                    |
| 1936-1950 | 970,000                           | 610,000                                    |
| 1951-1955 | 1,210,000                         | 940,000                                    |
| 1956-1960 | 790,000                           | 1,070,000                                  |
| 1961-1965 | 620,000                           | 1,280,000                                  |
| 1966-1970 | 690,000                           | 820,000                                    |
| 1971-1975 | 660,000                           | 370,000                                    |

Note: Figures for 1955 and after are the estimates of the Population Research Institute, Ministry of Welfare.

#### IV. Conclusions

As analyzed in the preceding sections, the rate of savings and economic growth of both pre-war and post-war Japan are relatively high. There exist several studies on the pre-war Japanese economy, analysing the causes of the high rates of savings and economic development, but relatively few on post-war conditions. Many of the points enumerated for the pre-war period are not applicable to post-war conditions. In spite of the multifarious changes in the social and economic structure, the dynamism of Japan's economy has not been lost after the War. It maintains a very high rate of savings and economic growth, almost equal to that of communist countries without resorting to regimentation. In this context, careful studies are needed to examine the mechanisms of the post-war Japanese economy, which is making such rapid recovery and progress.

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## URBANIZATION AND ECONOMIC GROWTH IN ASIA

### I

Few social institutions have been judged by poets and philosophers in such contradictory fashion as cities: they are represented as the source of moral evils; they are painted as the zenith of human achievement. How can these two images be reconciled? What was the role of cities in the unfolding of civilization? In what way can or must the experiences of the Western world be repeated if the present underdeveloped countries are to attain high levels of material welfare? Industrialization and urbanization have been regarded as closely related processes. The presence of large cities and of systems of cities is thought by some a measure of the degree of economic "maturity" of a country. This view implies that not merely urbanization as such, but a particular pattern of urbanization, is associated with economic growth. But the question may be raised whether there exists a necessary strict correlation between the two processes, whether industrial growth cannot take place by a process of planned decentralization, and whether, on the other hand, urbanization can appear without concomitant industrialization.

These queries may serve as an introduction for our investigation of the role of cities in the economic development of Asian countries. The problem we are confronted with here appears to be the following: the cities, especially the capital cities and other large centers, are on the whole new settlements. They often were founded by outsiders (e. g., Djakarta or Karachi), and their growth has been influenced largely by their position close to the sea and their role as gateways of international and inter-regional trade. Since the end of the war these cities have experienced a rapid rate of growth and have tended to assemble vast populations for whom neither employment nor housing and other facilities have been available.

The recency of their founding and growth, the absence of a tradition of urban consciousness, and the heterogeneity of urban populations have imposed serious strains on Asian and African cities. Poverty and crime, the absence of decent standards of housing, hygiene, recreational facilities, and other amenities are reported from the cities of all underdeveloped countries, and the incidence of slums and other signs of destitution is widespread.

These factors impinge upon the economic role of cities in South Asia. In terms of traditional cost-benefit analysis, the non-measurable costs--represented by these forms of social disorganization--are vast, and for cities to have, on the whole, a favorable effect on economic growth, their measurable and non-measurable benefits must be even vaster. It may well turn out that urbanization in Asia is proceeding at too rapid a rate, and that urban populations tend to be too heavily concentrated in a few primate cities.<sup>1</sup> Yet this urban growth and

1. Geographers have coined this neo-logism. See Mark Jefferson, "The Law of the Primate City", *Geographical Review*, Vol. XXIX, No. 2 (April 1939), pp. 226-232; on primate cities in Asia, see Norton S. Ginsburg, "The Great City in South-east Asia", *American Journal of Sociology*, Vol. LX,



even the high degree of concentration may be a necessary concomitant of social and intellectual progress. Since education is one of the most important means of improving economic performance in underdeveloped countries, the impact of cities upon the level and kind of educational facilities is of the greatest importance. And it is in this context that primate cities play an important role. For although the primate city, because of its large size, imposes heavier social cost, it also exerts a more profound and more lasting effect upon changing patterns of social behavior. In the primate cities of Asia which are seats of governments of new independent countries, the various elites, intellectual and political and economic, have their headquarters. There new ideas of government and economic policy are evolved. Moreover, the primate cities in Asia are the most important centers of cultural change, especially in those fields which vitally affect economic development: advanced education, new forms of business organization, new administrative practices, and last but not least, new technologies find a fertile soil in them; their intermediate position between East and West, their contact with world markets of commodities and ideas, their lack of many traditional bonds make them into eminently suitable vehicles for the introduction of new ideas and new techniques. If economic development is associated with modernization, the mediation of new, "more modern" forms of social action through the primate cities of Asia is an indispensable part of this process.

The picture we witness in many Asian countries is one which has no proper analogue in previous urban developments in the West. Although in pre-industrial periods primate cities existed there also, the overall cultural distance of these cities from the countryside surrounding them was never as great as in present-day underdeveloped countries. Although in their settlement patterns, and even in their overall population composition, the cities of Asia are closer to the countryside than was the case of European cities, except during short periods of their history, the cultural distance between city and countryside is greater in the newly developing countries than in Europe.

In addition to their newness and their foreign origin, the cities in underdeveloped countries are entities which are in many other ways very remote from traditional native culture. Their function has been and continues to be to a large extent that of gateways to the outside worlds. Since they are not clearly separate entities with their own laws and administration, they do not experience an ordered process of gradual incorporation and absorption of cityward migrants. Rather they grew haphazardly. People came, some of them stayed, and others went away again. Even those who stayed often maintained strong ties with the village, family, or region they had come from. The city was not always recognized by the immigrant as his new final home. It was a temporary residence, a place of passage. This has determined the ecological and the social forms of existence which evolved in cities of underdeveloped countries.<sup>2</sup>

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No. 5 (March 1955), pp. 455-462, and Rhoads Murphey, "New Capitals of Asia", Economic Development and Cultural Change, Vol. V, No. 3 (April 1957).

2. Some evidence of this pattern of urbanization is provided in the various studies included in UNESCO, Research Centre on the Social Implications of Industrialization in Southern Asia, The Social Implications of Industrialization and Urbanization, Calcutta, 1956. See especially the paper by M. B. Deshmukh, "Delhi, A Study of Floating Migration".

But in addition to this unstable floating population, usually at the lower margins of the social scale, the city harbors a more stable population among which the professional people, intellectuals, and members of the middling and wealthier strata stand out. These groups differ more from the common man in the countryside, the recent immigrant, and even the ordinary worker in the city than in Western countries. Above all, the economic differences between the two groups are usually greater. Next, differences in political power and social status are usually greater. Finally, differences in culture and world view are greater. If the urban elite is tradition-oriented, it is made up of literate priests and aristocrats; if it is a "modernizing" elite its members are Western-educated persons who often are far removed in their thinking and action from the less "secularized" and frequently still profoundly tradition-oriented rural masses. This cultural difference causes the greatest divergence between city and country in Asia and Africa; and the recent rapid growth of Asian cities which has brought so many rural people into the few metropolitan primate centers has tended to enhance this difference, especially as between social groups within the city.

This process of growth of urban areas has been speeded up since the end of the war, so that at present the countries of South Asia may be regarded, on the whole, as "over-urbanized". We arrive at such a judgment in spite of the fact that in Asia only one in twelve persons is a city dweller--as against one in eight in the world as a whole, approximately one in three in North America, and one in five in Europe--by the following reasoning. In Table I the proportion of the population in places of 20,000 inhabitants or more and of 100,000 inhabitants or more in several Asian countries is listed. For Asia, as a whole, approximately 13 per cent of the total population is "urban", and more than 8 per cent "metropolitan urban". Now urban populations are characteristically non-agricultural. Of course, industries are not entirely concentrated in cities, and in fact, there exist a sizeable number of rural cottage industries, as well as a few large-scale plants in the country. Hence, although the proportion of the urban population is only 13 per cent, the proportion of the non-agricultural labor force is roughly 30 per cent. However, at a similar degree of urbanization in the western countries, the United States (1850's), France (1860's), Germany (1880's), and Canada (1890's) had roughly 55 per cent of their labor force engaged in non-agricultural occupations.<sup>3</sup>

This fact has several consequences. In the first place, it is a sign that urbanization in Asia has probably run ahead of industrialization, and the development of administrative and other service occupations which are characteristically concentrated in cities. In the second place, it emphasizes the disproportion between the costs of urban growth and the maintenance of proper facilities for urban dwellers and the earning capacity of the people congregated in cities. In the third place, it is evidence that migration to the city is due less to the "pull", i. e., the attractiveness which the city exerts, and more to the "push" experienced in the country. In general the forces which tend to push people out of rural regions are associated with the increasing difficulty of making a living

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3. Cf. United Nations, Economic Commission for Asia and the Far East, "Economic Causes and Implications of Urbanization in the Recent Experience of Countries in Asia and the Far East", mimeographed document E/CN.11/URB/2, submitted to the Joint UN/UNESCO Seminar on Urbanization in the ECAFE Region, Bangkok, 8-18 August 1956, pp. 9-10.

Table 1. Total Population and Urban Population of the Countries of the ECAFE Region--1950\*

|   | Total<br>Popula-<br>tion 1950<br>(000's) | Population<br>in Places of<br>20,000 or More |                                  | Population<br>in Places of<br>100,000 or More |                                  | % of Urban<br>Population<br>Living in<br>Places of<br>100,000<br>or More |
|---|--|--|----------------------------------|---|----------------------------------|--|
|   |  | (000's)                                      | % of<br>Total<br>Popu-<br>lation | (000's)                                       | % of<br>Total<br>Popu-<br>lation |  |
| Hong Kong                                   | 2.260                                    | 2.124  | 94.0                             | 2.124   | 94.0                             | 100.0  |
| Japan                                       | 82.900                                   | 35.000                                       | 42.1                             | 21.222  | 25.6                             | 60.8   |
| Malaya and Singapore                        | 6.245                                    | 1.617  | 25.9                             | 1.119   | 17.9                             | 69.1   |
| Korea                                       | 29.291                                   | 5.557  | 19.0                             | 3.876   | 13.2                             | 69.4   |
| Brunei, North Borneo<br>and Sarawak         | 956                                      | 134  | 14.0                             | 0   | 0                                |  |
| Philippines                                 | 19.881                                   | 2.523  | 12.7                             | 1.013   | 5.1                              | 40.1   |
| India                                       | 358.000                                  | 42.960                                       | 12.0                             | 23.628  | 6.6                              | 55.0   |
| Ceylon                                      | 7.544                                    | 860  | 11.4                             | 407   | 5.4                              | 47.3   |
| Burma                                       | 18.489                                   | 1.850  | 10.0                             | 924   | 5.0                              | 50.0   |
| China (incl. Taiwan)                        | 564.477 <sup>b</sup>                     | 56.448                                       | 10.0                             | 39.515  | 7.0                              | 70.0   |
| Indonesia                                   | 75.500                                   | 6.870  | 9.1                              | 5.285   | 7.0                              | 76.9   |
| Cambodia, Laos and<br>Viet-Nam <sup>c</sup> | 30.000 <sup>b</sup>                      | 2.400  | 8.0                              | 1.950   | 6.5                              | 81.2   |
| Pakistan                                    | 75.040                                   | 5.853  | 7.8                              | 3.602   | 4.8                              | 61.5   |
| Thailand                                    | 18.488                                   | 1.410  | 7.6                              | 1.227   | 6.7                              | 88.1   |
| Afghanistan <sup>a</sup>                    | 12.000                                   | 540  | 4.5                              | 204   | 1.7                              | 37.7   |
| Nepal                                       | 7.000 <sup>b</sup>                       | 308  | 4.4                              | 210   | 3.0                              | 68.1   |
| ECAFE Region                                | 1.308.071                                | 166.494                                      | 12.7                             | 106.305                                       | 8.1                              | 63.7   |
| Total Asia                                  | 1.368.000                                | 179.208                                      | 13.1                             | 113.544                                       | 8.3                              | 63.3   |

a. 1951.

b. Unofficial estimate.

c. Comprising former Annam, Cochin-China, and Tonkin.

\* Taken from "Demographic Aspects of Urbanization in the ECAFE Region", prepared by United Nations, Population Branch for Joint UN/UNESCO Seminar on Urbanization, 8-18 August 1956, Bangkok, Thailand, p. 8.

there. In Asia many people have drifted into the city because political insecurity made living in the country impossible or highly dangerous, or because bandits and insurgents destroyed their homes, their land, or their crops. But even in those countries which have been spared from civil war and banditry, the push to the city has been exerted by the inability of a limited agricultural area to support the rapidly rising number of young people. Rural open or disguised unemployment became so impelling that the only way of escape was seen in migration to the city. In many Asian countries the migrants exchanged a precarious existence in the country for an equally precarious one in the city.

This tendency to over-urbanization in Asia has also an important political aspect. Owing to the greater concentration of population, the higher degree of literacy among urban than country people, and the propinquity to centers of

political decision-making, the urban population is more deeply involved in politics than the rural population. Moreover, the greater degree of literacy and the much greater degree of exposure to mass communication media make urban populations more susceptible to various forms of political propaganda. Thus, at present, the cities of underdeveloped countries, and above all their capitals, are the centers of nationalist sentiment and political action. But to the extent to which aspirations for economic advancement are not fulfilled or fulfilled only inadequately, urban populations may become a very responsive element for radical propaganda of various sorts and may easily be induced to support forms of extreme policies on the left or on the right. In view of the overwhelming political role exercised by the cities in underdeveloped countries and the relative political impotence of the countryside, the present situation of over-urbanization, coupled with the relatively unsatisfactory employment situation among urban dwellers, must be regarded as an important element of potential political and social instability.

## II

The outstanding characteristic distinguishing urban from rural areas in underdeveloped countries is an occupational structure oriented to non-agricultural activities. Manufacturing, and even more pronouncedly service industries, find a natural habitat in cities. This differential occupational pattern is well exhibited by evidence from India, presented in Table II.

Table II. Distribution of Working Population in India, 1951

| Industry  | Rural   |     | Urban   |     | Total   |     |
|-----------|---------|-----|---------|-----|---------|-----|
|           | Million | %   | Million | %   | Million | %   |
| Primary   | 71.3    | 84  | 2.7     | 15  | 74.0    | 72  |
| Secondary | 4.8     | 6   | 4.4     | 24  | 9.2     | 9   |
| Tertiary  | 9.1     | 10  | 11.1    | 61  | 20.2    | 19  |
| Total     | 85.2    | 100 | 18.2    | 100 | 103.4   | 100 |

Source: Census of India, 1951, Paper No. 3 (1953).

The data presented in this table speak for themselves. They do not surprise us, and although similar data for most of the other Asian countries are not available, they may be accepted as fairly representative of South Asia as a whole. In Africa the proportion of population engaged in secondary and tertiary industry is, if anything, smaller than in India and other countries of Asia.

Let us examine the figures for secondary and tertiary industry somewhat more closely. In absolute numbers, employment in manufacturing and processing was approximately equal in urban and rural areas. But proportionately a much larger share of the urban population was engaged in secondary industry. The Indian cities--and those of other Asian countries as well--have traditionally been the seats of handicraft industries and continue to be so. This means that with the growth of industry, the number of industrial and handicraft workers



who work on their own account have also increased, and in many Asian cities the number of salaried and wage workers in service trades and manufacturing does not exceed the number of self-employed persons.<sup>4</sup> In other words, the data presented in Table II must be interpreted in the light of Asian rather than Western conditions. As yet modern forms of industrial and service activities embrace only a relatively small portion of the labor force, and among this almost exclusively of the urban labor force. Almost all of the roughly 14 million persons in rural India who derived their livelihood from other than primary industries were small artisans, peddlers, traders, and the like. But rather more than half of the roughly 15 million persons engaged in secondary and tertiary industries in the cities of India, also belonged to this same group of small independent craftsmen or shopkeepers.

Although, therefore, there are some important differences in occupational structure and type of employment relations in cities and rural areas, these differences are limited to a portion only of the urban labor force. Thus, in terms of economic patterns of earning a livelihood and spending one's income, a portion of the urban population represents a transitional group between a model characteristic of rural areas and one characteristic of urban areas. Among the factors which contribute to the change in earning and spending patterns is residence in the city itself, as well as change in the job or employment status of the urban dweller. But the cultural, social, and political impact of living in the city has at least an equal impact as the change in employment or occupation upon this transformation of a rural tradition-oriented person to an urban secular-oriented one. This transformation can be well observed if we compare urban and rural earning and spending patterns.<sup>5</sup> If urban earnings are, on the whole, higher than rural earnings,

4. For example, in a social survey of occupational distribution in the cities of Taiwan, it was found that 31.8 per cent of household heads in 1953 were self-employed, and 31.3 were laborers. If we omit domestic servants, unemployed, and non-specified occupations, we find that of the remainder, 55 per cent are laborers, employees, and civil servants, and 45 per cent were employers or self-employed persons. In contrast, in Chicago, in 1940, the percentage of professional and managerial personnel and employers and self-employed was 29 per cent, and employees and workers 71 per cent. For data on Taiwan, see A. F. Raper, H. S. Chuan, and S. H. Chen, *Urban and Industrial Taiwan: Crowded and Resourceful*, Taipei, 1954, pp. 245-247. For data on Chicago, see Eleanor Bernert, "Changes in the Occupational Structure of the Labor Force in Chicago, Philadelphia, and the United States", in P. K. Hatt and A. J. Reiss, eds., *Reader in Urban Sociology*, Glencoe, Ill., 1951, p. 327.
5. Actual empirical data, especially comparative data, are extremely scanty. A survey sponsored by UNESCO in five Asian cities on the Social Implications of Industrialization and Urbanization is the first concerted attempt to provide data of this kind for the countries of Asia. Additional scattered data are available from census reports, some anthropological field studies, and a few special studies by independent researchers. For the studies sponsored by UNESCO, see the reference in footnote 2 of this paper. Quite recently a most impressive report with detailed data on Poona has been published which may be regarded as constituting a model survey, both from the methodological standpoint and the standpoint of completeness of coverage of relevant aspects of this problem. See N. V. Sovani, D. P. Apte, and R. G. Pendse, Poona: A Resurvey, Poona, 1956. See also Raper, Chuan, and Chen, op. cit.

this is counterbalanced by some factors which tend to make real living standards in the city and country more equal--excepting, of course, always a relatively small percentage of middle and upper income families. In the first place, it is likely that the dependency rate among urban income earners is higher than among rural income earners. This situation results from the change in family structure which is associated with the process of urbanization and in which the male head of the household tends to become the only breadwinner. In a city women have fewer opportunities for sharing in their husband's work than on the farm, and children remain longer in a dependency status. Secondly, the cost of living is higher in cities than in the country, a fact which is not surprising, since the urban dweller has to pay for the transportation and other services which were performed to bring the objects of his subsistence near to him. Finally, as people remain in the city, their pattern of consumption changes, and many items of consumption which are not consumed in the country--because they are unavailable there--are consumed in the city. The UNESCO study on the Social Implications of Industrialization and Urbanization is replete with examples of this changing pattern of consumption. In Bangkok, as well as in Delhi, in Dacca and in Bombay new commodities become available to the migrant into the city which he never had known or never been able to obtain before.<sup>6</sup>

The net effects of the greater dependency rate, the higher cost of living, and the evolution of wants for new types of consumers' goods has the overall effect that, in spite of higher incomes, urban populations are able to save little, and are found to be in debt as often as rural people. For example, Prabhu elicited some information of indebtedness from his sample of 523 respondents in Bombay. 448 only provided information of whether or not they incurred debts in order to send money home to their village, and only 41 per cent of those said that they did not incur debts for this purpose. The need to send money home, is, of course, not the only demand made on the financial resources of the urban wage earner. As has been shown by Prabhu, and most elaborately by Sovani and his associates in their study on Poona, the income earned by many persons in a city is often insufficient to support them and their families. Hence they incur debts, and the actual capacity to save is not substantially higher among the mass of the urban than the rural population.<sup>7</sup> The Asian city, therefore, has not yet succeeded in attaining one goal which urbanization usually produces in the long run: the abolition of mass poverty. Though urban incomes are well above rural incomes in Asia, at least half of the urban population lives on a level which is scarcely above and often below actual subsistence, i. e., on a level at which, with given prices, adequate nutritional, clothing, and housing standards required for sustained health can scarcely be met. The prevalence of poverty in Asian cities exerts an impact upon the public services which urban administrations can supply. If the incomes of city

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6. See for example H. B. Textor, "The Northeastern Samlor Driver in Bangkok", UNESCO, op. cit., pp. 29ff. and passim; see also the following articles in the same work: Deshmukh, op. cit., pp. 206ff., esp. Table 41 on p. 211; A. F. A. Husain, "Human and Social Impact of Technological Change in East Pakistan", p. 116; and P. N. Prabhu, "Bombay, A Study on the Social Effects of Urbanization", pp. 99ff.

7. On Bombay, see Prabhu, op. cit., pp. 72-73. On poverty in Poona, see Sovani et al., op. cit., pp. 440ff.

people are low, their taxable capacity is low, and hence the city government cannot acquire large funds for public works in the city. Thus we find often little support for streets, parks, hospitals, schools, and recreational facilities in municipalities in underdeveloped countries. Even such services as fire and police protection are often deficient and of uncertain quality. In view of the relative lack of fiscal autonomy of most cities in underdeveloped countries, the cities far away from the capital are usually much worse off in these respects than the capital. Here is another factor which enhances the tendency toward the formation of primate cities and reduces, in general, the economic and social impact which cities, especially those non-metropolitan centers scattered about the provinces, might exert.

### III

The economic impact of cities, which I have mentioned, consists primarily in the impact upon changes in the occupational structure and the pattern of earnings and consumption by which city populations are distinguished from rural populations in underdeveloped countries. Though little empirical research has been applied to these differences, our factual knowledge of the non-economic impact of urbanization is even scantier. I am aware of only one single effort which has been undertaken by Daniel Lerner to measure in a rather rigorous way the interrelation between urbanization and some non-economic variables.<sup>8</sup> Lerner's reasoning begins with the very plausible proposition that countries with different social structures and above all different educational levels of the population will use different forms of communication. In particular, the mass media of communication: press, radio, and movies will be found in countries with higher literacy levels, whereas oral communication will be found in countries (and by implication in parts of a country) with lower literacy levels. In fact, Lerner found that literacy is very highly correlated with daily newspaper circulation and the number of radio receivers in a community, and somewhat less highly correlated with cinema seating capacity.

Since we are interested here, above all, in the impact of urbanization upon some non-economic variables which may have relevance for economic growth, Lerner's findings are presented in Table III.

This table shows rather conclusively that urbanization is an important factor in the level of literacy up to the point at which approximately one-fourth of the population lives in cities of 50,000 or more. Beyond this point, literacy is only little affected by further urbanization. The results of this table appear in even sharper focus if we group the various countries into three classes, those with 25 or more per cent of their population in cities of over 50,000; those with 10 to 25 per cent of their population in cities of this size; and those with less than 10 per cent in cities of this size. We then find that literacy in countries of the first class is over 50 per cent, that literacy in the last class is below a quarter of the population, and that literacy in the second intermediate class lies between 50 and

8. Cf. Daniel Lerner, "Communication Systems and Social Systems", Cambridge, Mass., 1957, unpublished manuscript. Lerner's main interest was the impact of different forms of communication upon the direction and speed of social and economic change. His empirical work was done primarily in the Muslim countries of the Middle East, but he later developed a series of propositions which are applicable to all countries regardless of their level of economic development.

Table III. Degree of Urbanization and Literacy Rates in 71 Self-Governing Countries

| <u>Number of Countries</u> | <u>Literacy</u> | <u>Urbanization* (Mean)</u> | <u>Population Density per Square Kilometer</u> |
|----------------------------|-----------------|-----------------------------|--|
| 22                         | over 80%        | 28.0%                       | 1-293  |
| 4                          | 61-80           | 29.2                        | 6-223  |
| 10                         | 41-60           | 25.0                        | 8-111  |
| 13                         | 21-40           | 17.0                        | 6-124  |
| 22                         | 20% and less    | 7.4                         | 3-143  |

\* "Urbanization" is defined as proportion of population living in cities of more than 50,000 inhabitants.

20 per cent of population. Correspondingly, the preponderant forms of communication in the first class are the mass media; in the last class are oral communication, usually in the form of commands and orders given by persons in high status positions; and in the intermediate class are mixed, comprising both some rudimentary mass media and oral communication.

Lerner's investigation is concerned only with differences in urbanization, literacy, and the use of mass media as between different countries. For lack of more detailed data, he took averages for the various countries of the world. However, I believe that here is a point where a conclusion a maiori ad minus is appropriate. In other words, the differences which prevail between countries with different degrees of urbanization may be assumed to hold also in approximately the same degree between different regions within one country. This is even more likely in countries with little industrialization, since, as we have seen earlier, there are significant socio-structural differences between the countryside and the cities. Now according to Lerner's findings, one of the crucial breaking points is a degree of urbanization of 10 per cent. Since Lerner includes under "urban" all places with more than 50,000 inhabitants, he uses a classification which is somewhat different from that presented in Table I of this paper. But we find that, with the exception of Hong Kong, Japan, Malaya, and Korea, none of the Asian countries has more than 14 per cent of its population in urban places of more than 20,000 inhabitants, and more than 7 per cent in metropolitan places of more than 100,000. Thus we do not go wrong in assuming that with the exception of these four countries, all Asian countries fall in that group of nations in which approximately not more than 10 per cent are urban as defined by Lerner. In Africa the degree of urbanization is, if anything, still lower than in Asia. In the countries of Asia and Africa, an increase in urbanization will contribute to an increase in literacy, the use of mass media of communication, and the additional consequences which follow from these developments. Yet, at the same time, we have found that in terms of distribution of the labor force, these countries are "over-urbanized", and this verdict must be further sustained in terms of the economic potential of the urban population in Asian and African countries.

A real dilemma emerges here since, on the one hand, efforts should be made in Asia to encourage rural industrialization, since urbanization has reached for the time being a more than optimum level, and on the other hand, further



urbanization would be likely to lead to improvements in literacy and the social and economic consequences brought about by higher levels of literacy. If we assume, moreover, that literacy increases in the propinquity of cities and towns, the problem appears in even sharper focus. One important solution of this dilemma appears to be the drafting and implementation of plans for urban or quasi-urban developments which will tend to reduce the degree of primateness in Asia. In other words, the problematical situation of Asian cities consists not merely in the average overall degree of urbanization as compared with the distribution of the labor force, but also in the absence of more viable systems of cities, i. e., of systems which correspond more precisely to a Pareto distribution.<sup>9</sup>

## IV

The gradual evolution of such a system of cities demands, above all, the filling up of the gap that exists at present between the primate metropolis and the larger number of small and even minute country towns. But since these medium-sized cities and towns need an economic basis for their existence, a dispersal of secondary and tertiary occupations is one of the conditions of evolution of a system of cities.

The major form of rural or small-town industrialization which has been proposed is the location of small-scale or handicraft industries in places outside the larger cities, and the concentration of large-scale industry in the big cities themselves. To the extent to which the occupational structure of cities is as yet characteristic of pre-industrial primate cities, i. e., as long as a large proportion of the urban population is composed of self-employed artisans, peddlers, or of actually unemployed, further industrialization, on a large or medium scale, is clearly called for. This development is necessary not only in order to assure the optimum integration of the urban economy in the process of economic development, but also in order to forestall political developments in the cities from taking on totalitarian or other disrupting features.

The further development of large-scale industry in cities will, of course, not eliminate by itself the many small self-employed artisans that are now being found there. As has been observed in the more highly developed countries, the growth of large-scale industry does not replace small enterprises completely, but changes their form and nature. Instead of large and small-scale firms in the same industry existing side by side, the smaller firms tend to perform economic functions subsidiary to the output of the larger firms: for example, the development of a mass-production automobile industry, which is characteristically organized in plants of giant size, calls forth the development of garages, gasoline stations, repair shops, on the one hand, but also suppliers of various parts such as stoplights, windshield wipers, etc., on the other. Characteristically, the producers who "cluster" around the manufacture of automobiles are small-scale enterprises.

Thus the "ideal" pattern of industrialization for Asian countries, given the present situation of "over-urbanization", the existence of actual or threatening underemployment on farms, and the desire for relatively rapid betterment of

9. On the Pareto distribution, see Rutledge Vining, "A Description of Certain Spatial Aspects of an Economic System", *Economic Development and Cultural Change*, Vol. III, No. 2 (January 1955), pp. 148ff.

living conditions for the masses of the population would seem to call for a series of concerted measures. In the cities which already enjoy to some extent the benefits of external economies for industries of various sorts, further growth of large-scale industry should be planned. For the rest of the country, chiefly small-scale industries clustering around a few nuclei of small and middle-sized towns should be developed. The products of large-scale and small-scale industries will differ. For example, in India's Second Five Year Plan, large-scale industries are prescribed primarily for heavy capital goods, whereas small-scale and cottage industry is to be developed in consumers goods industries. Such a division may be a bit too sweeping, since there are certain consumers goods which lend themselves well to large-scale production (e.g., cheap cotton textiles), and there are some capital goods which lend themselves to production on a small scale (e.g., gauges and measuring instruments).

Any such simultaneous development of large and small-scale industry and its location in large cities and smaller towns or villages faces two problems. First, can small-scale industries be devised so as not to be a mere temporary solution, i.e., so as to be sufficiently economical not to be pushed out of existence after a short life by gradually developing larger plants? The second problem relates to planning industrial development in such a way as to insure dispersal of industry, on the one hand, and yet not to sacrifice in the process locational advantages and advantages deriving from external economies.

Whatever may be some of the accessory purposes of support for small-scale industries, their main purpose should be to further the economic growth of the country in which they are located. Though at first considerations of make-work or saving of foreign exchange were paramount in the eyes of those who discussed small-scale and cottage industries, a new attitude is being expressed more recently. This "new look" for small-scale industry was explained by the Director General of the International Labor Organization in 1953. In this statement the employment argument still prevails, but in view of the different relative scarcities of productive factors in Asia and the Western world, a form of industrialization which is oriented in the direction of maximum productive employment of the human factor is at the same time also one in which scarce (and hence expensive) capital tends to be substituted by the more plentiful (and hence cheaper) labor. This opinion of the Director General of the ILO has become more and more widely accepted in Asian countries. In Burma and Indonesia, and most importantly, in India the development of small-scale powered industry has been included in governmental development plans. The reports of the representatives of the ECAFE Study Group on Small-Scale Industry presented on the occasion of the inspection tour of Japanese small-scale industry present further evidence for this attitude. Delegate after delegate expressed his appreciation of the Japanese achievement in creating an efficient small-scale industry and the hope that his country could do likewise.<sup>10</sup>

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10. In Japan, the success of small-scale industry has indeed been impressive. But the conditions under which small-scale industry developed and continues to be maintained in Japan may not easily be copied elsewhere. Apart from important economic assistance which Japanese small industry has received (which is described in more detail in the book by Teijiro Uyeda, *The Small Industries of Japan*, New York, 1938), partly from the natural conditions existing in Japan and partly through legislation affecting marketing, the supply of capital, and other aspects of small-scale production, Japanese social structure has had an important influence on

Perhaps the best summary of the position widely held among planners and members of industrialization commissions and similar agencies in South Asia was represented by the delegate from Ceylon. He said that the new Minister for Industries, Sir Kantiah Vaithianathan recently concluded that:

...the failure of previous industrialization plans is directly attributable to the fact that at the prevailing stage of industrialization in Ceylon, neither large-scale industry nor pure cottage industry (as these terms are generally understood) can be considered appropriate to solve Ceylonese economic and industrial problems. He has therefore propounded the theory (quite novel to Ceylon) that Ceylon's immediate industrial future is almost entirely in the field of small-scale industry. It is difficult to define the range of small-scale industry, but in general, Sir Kantiah considers that the following considerations should apply: (1) the industry must be competitive and work to commercial standards sufficient for all purposes; (2) the industry must be more labour-intensive and less capital-intensive; (3) there must be sufficient mechanization to enable production and productivity to be competitive, but not simply for the purpose of monopoly or control by capital or merely to avoid trade union action; (4) the element of private enterprise must be encouraged to the maximum extent possible.<sup>11</sup>

This statement expresses very well the manifold dimension in which small-scale industry may contribute to the economic development of countries in the overall economic position of most countries in South and East Asia. Perhaps one should add two further points to the enumeration of the Ceylonese delegate, i.e., that small-scale industries should not be concentrated in the large primate centers, and that the establishment of a small-scale industry should be motivated not by the desire to introduce make-work schemes, but to contribute to the effective economic development of the country. The more room for the free exercise of private initiative is given in the growth of small-scale industry, the more likely will this last objective be met. On the other hand, it is recognized that the completely free allocation of capital in many underdeveloped countries may have undesirable short-run effects, since often private net gains from certain enterprises are substantially larger than the net gain of the society as a whole.<sup>12</sup>

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the long-run evolution and growth of small-scale industry. The economic factors could be imitated in other Asian countries. The particular impetus given to small-scale industry by the Japanese social structure is a unique feature of that country which cannot be transferred elsewhere. See also Bert F. Hoselitz, "Population Pressure, Industrialization, and Social Mobility", *Population Studies*, Vol. XI, No. 2 (November 1957).

11. Economic Commission for Asia and the Far East, Report of the Study Group of Small-Scale Industry Experts on Their Visit to Japan, Tokyo, 1955, United Nations Document E/CN.11/I and T/108, pp. 200ff., esp. pp. 204-205.
12. An example might be the use of scarce building materials for the construction of a night club or a luxury apartment house. Clearly, an adequate system of "luxury" taxation would be a suitable means of discouraging such use of capital without interference in the market as a mechanism of resource allocation.

As I have implied throughout a good portion of this paper, the development of small-scale industry might also be used as a means of dispersal of industrialization and the concomitant strengthening of a more evenly distributed system of urban places. One way of achieving this objective is the inclusion into national development programs of urban development plans and the simultaneous development of regional capital budgets. A full discussion of these points would require another paper, and hence only a sketch of these two planning devices can be presented.

The inclusion of urban planning into national developmental planning is necessary because of the prospective further growth of cities in underdeveloped countries. Unless planned provision is made for the development of new and expansion of present urban centers, the costs of urbanization are likely to be vast in the long run. By urban planning some of the effects of social disorganization which occur inevitably in the urbanization process can be mitigated. For example, the incidence of slums and sub-standard housing can be avoided and a more economical use of urban space can be insured. Under present conditions, urban planning is almost completely non-existent in underdeveloped countries. In part this is due to the very stringent financial conditions of municipalities in underdeveloped countries, in part to deficiencies of public administration, especially on the local level, but in part also to the absence of concern for urban growth in the overall development plans which are being prepared in underdeveloped countries.<sup>13</sup>

Urban planning can be coupled with the development of regional capital budgets. An approximation of regional capital budgets is already in existence in large countries like India, which are composed of topographically and economically distinct areas. But even there, adequate regional capital budgets are lacking. Since a large proportion of total capital outlays for development are made in urban areas, regional capital budgeting would provide a guide for the distribution of these capital outlays, chiefly for social overhead among the different portions of a country. If industry is to be dispersed, one must obtain some reasonably accurate knowledge of the allocation of capital for the construction of social overhead installations in the various urban regions of a country.

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13. On municipal finances in underdeveloped countries, see Joseph Froomkin, "Fiscal Management of Municipalities and Economic Development", Economic Development and Cultural Change, Vol. III, No. 4 (July 1955), pp. 309-320; on public administration and possibilities of its improvements, see Frederick W. Riggs, "Public Administration: A Neglected Factor in Economic Development", in The Annals of the American Academy of Political and Social Science, Vol. 305 (May 1956), pp. 70-80. See also Catherine Bauer, "The Pattern of Urban and Economic Development: Social Implications", Ibid., pp. 60-69.



## THE INTELLECTUALS, PUBLIC OPINION, AND ECONOMIC DEVELOPMENT

Economic development in the West until the latter part of the 19th century proceeded without the aid of the intellectuals. Neither the innovators in technology or the enterprisers and managers of industrial firms were highly educated, nor did they interest themselves in intellectual matters. The graduates of universities went into scholarship, into theology and the church, into administration (first in Germany and then gradually in the rest of the countries of Europe), into medicine and the law, but they did not enter into the commercial and industrial life of their countries.

Fortunately at the time there was no need for them. A tradition of inventive and artful craftsmanship, especially in the engineering trades, and indomitable ambition and resourcefulness among businessmen provided the motors for the enormous economic progress of Europe from the 16th to the end of the 19th century. The nurture of technological development through the deliberate cultivation and application of science came only at the end of this period. It was only in the present century that great laboratories of scientific research, primarily applied but also pure, have been established by large corporate enterprises and by trade associations. Plastics, synthetic fibers, light metals, jet propulsion--all of these and many more of the characteristic advances of modern industrial technique have been discovered in research conducted by graduates of departments of physics, mathematics, chemistry, metallurgy, aeronautics, etc., of the great universities and technical colleges. Even so, much of the driving force of contemporary industrial development in Canada, the United States, Belgium, Italy, and Western Germany, etc., still comes from outside the educated classes. (Although many enterprisers are university-trained, that fact usually has little to do with their entrepreneurial activity).

The situation of the newly emerged countries, e.g., India, Indonesia, Burma, Malaya, Gold Coast, and Ceylon is rather different. These are countries without either the class of innovating craftsmen in industry or of innovating risk-taking industrial entrepreneurs. Their craftsmen, however skilful, work within definite traditions and require close supervision when confronted by new problems; their industrial entrepreneurs have been primarily foreigners, for their own businessmen find their talents drawn to commerce and finance. The proponents of industrialization and modernization--although not necessarily the sole or even most effective agents--are the intellectuals. In most of the new countries, prevailing opinion does not believe that industrial development will be able to come through the entrepreneurial processes that produced it in the West. This view rests on a derogatory conception of businessmen as either exploitative foreigners or money-grubbing short-sighted nature manipulators of financial combinations. There is no confidence in their constructive powers, in their willingness to take risks or even in their interest in making money through industry. In fact, of course, this disesteem for business enterprises derives from a deeper disesteem for their function and activity as such. Whatever the source, though it seems clear that in their efforts to advance industrially, the ruling groups in new countries are not inclined to entrust much of the responsibility for this advance to private businessmen.

The alternative source of personnel for industrial progress therefore must necessarily be the educated classes or the intellectuals--the university-trained government official, the scientist, the economist, the engineer with a systematic training in a technological college, rather than an empirical training at the work-bench, etc. Economists well trained in both theoretical and applied economics are even more integral to the promulgation and execution of plans for economic development than they are in long established countries with a large stratum of experienced and forceful businessmen. A country like the United Kingdom, which decided to launch itself into governmentally planned economic life and university-trained economists after the Second World War, had a substantial body of able businessmen to draw into government service to supplement the Civil Service. The poorer countries have no such resources. The more fortunate among them have a small number of high grade economists taken from the universities and experienced Civil Servants. They have very few businessmen to enlist into their service (and even if they had them they would be unlikely to do so). They could all use more highly qualified economists and economist-administrators than they have available at present. Their vast schemes of construction--hydroelectric installations, factories, railways, etc.--all require engineers trained in higher technological institutions. The improvements of their agriculture requires agricultural research and extension work which will demand men with university training. Moreover, the aspiration in almost all the new countries for a "welfare state", can be met only if there are far larger numbers of teachers, physicians, social workers, and, as literacy spreads, journalists, scenario writers, authors, and the like. Programs of economic and social progress will thus depend for their fulfillment on the executive action of large numbers of intellectuals. Practical judgment, hard-headedness, the appreciation of piece-meal changes rather than apocalyptic transformation will be the order of the day for intellectuals in the underdeveloped countries.

## II

The newly emergent countries in Asia are the heirs of a powerful intellectual tradition, predominantly religious. The religious sage has enjoyed the highest esteem, and the religious conquest of the concrete self or individuality has been one of the highest goods, if not the absolutely highest. Non-attachment to the objects of this world and the purification of the spirit by avoidance of the gratification offered by contact with living and non-living material objects have been central features of the tradition of intellectual activity in these countries. Moreover, because the religious component has been so preponderant in the cultural tradition, much of the most refined intelligence has been given to the interpretation of the texts. The traditional institutions of learning have concentrated on the exegesis of sacred texts. Daily experience, the experience of the craftsman and reflection thereon and curiosity about the world of natural phenomena, physical and biological, have been as absent from the range of activities of the traditional intelligentsia of these countries as they have been from the life of their ruling classes.

At present the traditional intellectuals, e.g., the pandits in India, are looked upon with condescending pity or outright contempt by the modern intelligentsia of these countries. What the traditional intelligentsia regards as sacred, their modern counterparts regard as supersition or triviality. There is little contact between these two sections of the intellectual classes. Their modes of life, their intellectual satisfactions and curiosities seem to be poles apart. Nonetheless, a deeper affinity exists between them, and this affinity has important implications for economic development.

The affinity is evident in the theoretical and literary tendencies of the modern intelligentsia in the underdeveloped countries. How few study engineering or natural sciences, especially the experimental sciences. How vast is the disproportion between those who have taken degrees in the arts, in law and commerce, and those studying science and engineering. Wherever in the economically underdeveloped parts of the world there is an ongoing university system, it is flooded with candidates for arts degrees for whom there will be very few opportunities for employment.

This is in part attributable to the impact of the West. The Western rulers created universities and colleges in India and Burma, in Indonesia, etc., to supply middle and lower level civil servants, the highest positions being reserved for their own nationals or for persons of local origin who had met the highest intellectual requirements of the metropolitan university system. When colleges were founded by local initiative, they were of the same sort. These colleges were not intended to make men into scientists and engineers: the British Universities, which served as the mold, did not produce scientists and engineers and did not think it was the task of universities to do so. Moreover, there was an absence of employment opportunities for native engineers and scientists; higher technical personnel, when needed, were imported from the metropolis.

The origins of the relative indifference towards the intellectual and practical mastery of nature can thus be seen to be rooted in the older traditions of each country and in the recent traditions established by the method of domination employed by the foreign ruler. Because of these traditions, the educated classes of the underdeveloped countries, however much they believe in the saving graces of science and technology, have a largely literary or ideological relationship to them. In practice, being an engineer or an applied scientist does not count for as much in the eyes of the educated as having a good humanistic education.

Moreover, although there has been a revival of appreciation for the inherent qualities of traditional art, music, sculpture and religious philosophy, there is even more prestige attributed to a thorough familiarity with the culture of the West. It is not only the man who has studied at Oxford, Cambridge, Heidelberg, or Paris who is deferred to, but the person who, whether he has studied abroad or not, is intimate with the contents of the New Statesman and the Economist, who knows about Bertrand Russell, T. S. Eliot, Sartre, Graham Greene, Camus, Auden, and Faulkner, who is at home in the conflicts within the British Labour Party and the plays of Christopher Fry. Even among scientists in these countries work seems to be done for an invisible jury of scientists in England, the United States, and Germany, while other scientists working in the same field within their own country are less frequently thought of or referred to.

This location of the intellectual center of gravity in a foreign country, and indeed in a Western country, may be attributed to a more realistic or refined appreciation of the quality of scientific, literary, and philosophical work in the West. If this were only so, it would not injure the cause of national improvement and economic development. It is because fundamentally it arises from xenophilia that it harms the culture, science, and economy of the underdeveloped countries.

The coexistence of xenophilia with fervent nationalism does not diminish its pernicious consequences. Indeed, extremist nationalism is often an unconscious expiation for guilt-generating but status-enhancing xenophilia. The harmfulness

of xenophilia does not lie in its alleged "separation of the intellectual from the people". (Intellectuals in all countries are separated from "the people", and they should be. No society can have the indispensable division of labor if the different skills which it requires were not also associated with separate tastes and outlooks.) The real disadvantage of xenophilia is that it arises from and fosters a lack of intimacy with the material environment and is a form of social blindness to the capacities and incapacities of one's fellow countrymen and their problems. It is a product of a hierarchical society, in which the higher castes and classes had little feelings for those beneath them, and of the religious tradition of non-attachment. Its result is the existence of an educated class with little deeper understanding of the real state of mind and the real problems of the country.

### III

Ordinarily in the discussion of economic development through planning, stress has been laid upon the adequacy of quality and quantity of planning and administrative personnel. But sufficient attention has not been paid to the evaluation of what the planners and administrators have done. Insofar as it is treated at all, it seems to be taken for granted that the government will do its own evaluation, or some foreign experts will be called in by the government to assess the effectiveness, balance, etc., of various development projects of the scheme of development as a whole.

This does not seem to be sufficient. The government, least of all where it claims to be democratic, should not be its own sole judge. But such it will be if it monopolizes the machinery, personnel, and opportunity for factual evaluation of past activities and prospective plans. Nor do I think that foreign experts can be relied upon. They will usually lack the concrete sense of the situation without which there can be no realism, and furthermore, they will too often flatter the government in that condescending way which Western experts have in dealing with the efforts of the economically underdeveloped countries to improve their conditions. Even if they were acquitted on both these charges, a country which is trying to practice democracy must actually practice it. This means that evaluation and criticism must be carried on by independent organs within the country, staffed by independent personalities of the same culture as those they criticize.

With all qualities and with all good will, those who make plans and try to carry them out get a vested emotional interest in what they are doing and have done. They tend to gloss over their failures, to overlook obstacles, and in general to avoid the self-criticisms necessary for better action in the future. There are good reasons for this: they are excessively busy in all the governments of the new states, being understaffed at the higher levels; and the vast overstaffing at the lower levels of the government service does nothing to mitigate this.

Furthermore practically all of the higher civil servants and economic advisors are intellectuals by training and disposition. They are modern in their outlook and Western in their orientation (if not necessarily in their politics). As such they tend to be distrusted by the politicians, who though often intellectuals themselves, are more populist and even demagogic, and therefore critical of those who have studied abroad, who live in a more or less Western style at home, and whose university and intellectual attainments are often higher than their own. To avoid trouble and to do their duty, civil servants will often act against their better judgment because after having attempted to dissuade their superiors from a given line of policy, they have no alternative but submission. The short supply of talented and trained intellectuals is accentuated by the large-scale operations of the



governments. The best are taken into the government at larger salaries with higher prestige and better conditions of service than they could find in universities and colleges, in newspapers and reviews, or in native-owned private business. In consequence, the instructed public opinion in the middle classes and in the country at large is disarmed at its very center, when, thanks to the complex of inheritance, that center was weak enough to begin with. For all these reasons, self-criticism within the government is bound to be deficient. And since so many of the new countries wish to move in a more or less socialistic direction, the criticism which the competitive market and bankruptcy provide in the system of private capitalism cannot be effective.

The chief organs of an instructed public opinion--of a critical attitude which shares the general objectives of the government, feels a tie of solidarity with it and wishes it well--are the press and the universities. Where the broadcasting system is in the hands of the government or a public corporation, then it requires a great deal of subtlety and sophistication on the part of the broadcasting administrators to attain a stage where criticism of government actions is permitted, and this stage has not yet been attained. The press and the universities therefore--both newspaper and periodical press--must carry the burden of responsible criticism and the instruction of public and governmental opinion.

The other burdens of the press in these new countries are great, however: e.g., the high illiteracy rates and poverty of the mass of the population which restricts the circulation of newspapers, and therewith the income from sales and advertising by private business. Newspapers as a result live usually on a very narrow margin and come to depend for a larger share of their advertising revenue than in the West on government advertisements or announcements. This makes for caution in criticism. Poverty also means that salaries are, in the case of the vast majority of journalists, poor, and the press, as a result, finds it difficult to attract high-grade young men and to retain them. Staffs have to be kept small so that there cannot be sufficient specialization to develop the expertise which is necessary for evaluation and criticism of economic programs to be useful. Other impediments to the creation of a critical public opinion lie more deeply rooted in the past. The state of non-attachment to the objects of the phenomenological world is expressed in journalism in factual uninterestedness. It is not that false facts are deliberately presented, although that is not infrequent; rather there is lacking that avidity for facts, that concrete curiosity to know "what, where, when" which marks the good journalist and which must also be at the base of the higher type of analyst and commentator on current events.

This unfactual disposition is reinforced by a hortatory and polemical style, inherited from the period of struggle for national independence which came to the fore in the second quarter of the present century. The press tends to be stuffed with reports of speeches by cabinet ministers, members of parliament, and with the substance of official releases. Even significant reports, very factual in character, by parliamentary enquiry committees, find no response in the press, because they are not in harmony with the tradition which still finds it easier to write about Western foreign policy and the misbehavior of white people toward colored people than about the day to day problems of their own societies.

In the press of the new countries, there is no dearth of abusive criticism from irresponsible malcontents who do not bother to inform themselves and who wish ill to the government. This abusive criticism is like the barking of an ill-natured dog; it is heeded only when it is expressed by a party or a group-interest

strong enough to do political damage. The hostile critics, and even those who share with the general aims of the government, both lack the factual sense and the facts themselves on the basis of which realistic assessment and constructive suggestions could be offered.

But even if the full supply of facts were accessible, sympathizers with the ends of the governmental policies tend to be reluctant to criticize the government in public. The most secure as well as the more unstable of the new states are feeling their way amidst difficulties and their more responsible citizens appreciate their national independence too much to wish to give the appearance, above all to foreigners, of "letting the side down" by public criticism.

These are some of the reasons why there is so little informed and responsible criticism, and so little factual reporting in the press of the economically underdeveloped countries. Accordingly, the reading public gets practically no training in the careful formulation of its opinion on public matters, and the government has to depend largely on its own internal machinery for the discovery and correction of its errors.

#### IV

The effective evaluation of economic policies and practices depends on the more basic enquiries such as could be conducted, and in some countries are conducted, by the staffs of independent universities, colleges, and research institutes. The views of the latter in the form of journal articles, monographs, books, lectures, and seminars, and newspaper and periodical articles can contribute greatly to governmental economic policy. The formal incorporation of university intellectuals as consultants and advisors on governmental economic activities is no substitute for these, however desirable and important it is.

This is not the place to discuss in detail the sad condition of the institutions of higher learning in the new countries. Their teachers are overworked, underpaid, disesteemed; they have very poor libraries, they have little time, facilities, or energy for research, and neither they themselves nor their superiors expect them to show any independence in initiating or conducting research on important subjects.

Unlike the Western countries where, in one way or another, there exists a tradition of factual research on issues of importance to the public good, there is practically nothing like that in the academic life of the new countries. The Oxford Institute of Statistics, the Cambridge Department of Applied Economics, the National Bureau of Economic Research, so closely connected with Columbia University, the continuous stream of individual studies, by qualified university economists, sociologists, and political scientists, of the problems on which the government works and of the quality of its work on them, have no real counterparts in the new countries. Even the Institute for Economic and Industrial Research in New Delhi, the most independent of such bodies, seems to be confined by its terms of reference to working on problems referred to it by the Government of India. There is no reason to believe that governments are always the best judges of what research will be most fruitful for genuine economic advancement. There is at present no tradition of independent social research in the new countries, and the Committee of Research Programmes of the Planning Commission (Government of India), UNESCO, and other agencies seem blamelessly to be doing very little to foster it.

Nor is the prospect for improvement very bright. Because the universities and the government draw from the same stream, the universities might be more hard put to it than the press to develop a tradition of responsible independent criticism of government economic policy and practice. As soon as a well trained young man comes back to his country from a Western university, with an advanced degree and some training in rigorous analysis, he is usually offered a well-paid post in some Ministry and no more than a vague prospect of an ill-paid post in a college or university. If he accepts the former he will probably enjoy, in addition to higher salary and prestige and the feeling of helping his country in the immediate future, the company of other persons of outstanding intellectual and cultural qualifications. If he accepts the university or college post, he will have in addition to a poorer salary, a very inferior library, etc. He will furthermore have older colleagues who are jealous of his intellectual attainments and ambition and who are unable or unwilling to provide stimulating intellectual companionship. So, in most cases, the government appointment is accepted, and the colleges and universities become, with a small number of distinguished exceptions, the receptacles of leftovers and the second class. Few indeed are the outstanding young men who leave government service for the university; far more go the opposite way. And so the cycle goes, reinforcing itself with every completion of the cycle.

Again the result is the same as it is in the case of the press: the government's planning activities are deprived of sympathetic and helpful criticism, officials do not learn to benefit from criticism and instead develop a secretiveness and touchiness which is injurious to efficiency in economic life and to political democracy.

## V

The empirical outlook, concreteness in judgment, and intimacy with the realities of economic life are prerequisites, among many others, for economic development. These qualities must be husbanded and cultivated, so that in time they provide influential models for the development of the oncoming generations of intellectuals from whom the rulers of the countries will be drawn.

How can this be done? All I wish to do here is to make a few suggestions for purposes of discussion.

1. Insofar as it lies in their powers, governments should attempt to foster a sense of autonomy in the press and in the institutions of higher learning. This can be done by the studious avoidance of political pressure or the powers of patronage to influence the expression of academic opinion. More than this, financial and fiscal policies which can make the press and universities more economically self-sufficient are necessary.

2. Journalists and professors should be invited to participate in governmental and private economic enterprises as regular staff members with full responsibilities for periods of a year or two at a time, after which they should return to their universities or papers at the level of seniority or rank they would have attained if they had not left.

3. One or two first class universities or colleges should be maintained with salary levels and conditions of service comparable to what the higher Civil Service provides for equally qualified persons. This would prevent the government from making away with the best brains in the academic world; it would make the academic

career just as attractive financially and intellectually as the higher Civil Service and would thus provide a base from which the informed assessment and criticism of economic policies and trends could be developed.

4. Governments should develop more adequate reporting practices, making it easier for journalists and professors to learn, independently of the government press officer, just what has been going on in the economic life of the nation. Civil Servants should be allowed to give to journalists or qualified research workers all information which need not be kept secret on grounds of military security.

5. It would be desirable that the new countries develop something like a system of Niemann Fellowships at Harvard for their own journalists. This should allow for advanced academic study and research, and it should be given as a reward to those journalists who have shown most independence and intelligent persistence in pursuing some problem in the economic and political life of the country.

6. Above all, advanced technical training should be carried on in centers on the style of the Massachusetts Institute of Technology, the Zurich Eidgenassische Technische Hochschule or the California Institute of Technology. Each large new country ought to exert itself to establish one of these institutions, spending large sums of money if necessary to attract outstanding teachers of engineering and scientific subjects and providing them with facilities for research, so that there will be an ample supply of technologists. If this would be done, there would not only be an adequate supply of technologists for economic development, but there would begin a diffusion of the matter-of-fact and practical attitude which often accompanies the more specifically technical skills. Both of these are important for economic development and for political stability.

7. The principle of a permanent higher Civil Service, which has been adopted from the British model, has a great deal to commend it. Yet, from the point of view of bringing into government an outside perspective and of making outside criticism more concrete and more pertinent, some modification might be in order. Might it not be desirable to send senior civil servants who have the desire and the aptitude, to do research, journalistic work, or teach for periods of a year or two at a time, with the civil servant resuming his post at a level and seniority which he would have enjoyed had he not taken the leave of absence. Such an experience might give economist civil servants a more critical perspective on the economic state of their country, and it would correspondingly instruct those with whom they come in contact during their "outside" period.

All these measures and others are all intended to bring together the different sections of the intellectual classes of the new countries, to make them more realistic in their attitudes, more appreciative of the real problems faced by their countries, more aware of what each has to contribute to the total job of economic development. If any of them were to succeed only in bringing about the uncritical affirmation of governmental policies by journalists and professors, then it would be a failure. It would be a failure because uncritical affirmation is as useless to realistic action as undifferentiated nagging. These are the two temptations which menace the good sense of intellectuals in all countries, and not the least in the new countries, and they must be equally avoided if standards of living are to be raised and freedom fortified.

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## ECONOMIC GROWTH UNDER CENTRALIZED AND DECENTRALIZED PLANNING JUGOSLAVIA - A CASE STUDY

The purpose of this paper is to describe the shortcomings of centralized, administrative planning in Yugoslavia (1947-1951) and the efforts to replace it by a new system of a more liberal, competitive, decentralized, socialist planned economy (1952-1957). Three variants of planning have been or are being tried. First the method of the Wage-Bill-Saving-Rate (1952-53) in which all accumulation, i. e., taxes and contributions to the social funds, were made proportional to the wage bill. The second, the Workers' Participation System (1954-56), in which the state, the local authorities, and the enterprises themselves participated in the sharing of profits together with the workers. Thirdly, an amalgamation of the two was introduced in 1957. For the Second Five Year Perspective Plan (1957-61), now being drawn up, a combination is being worked out which will take as its basis Marx's scheme of reproduction combined with an input-output method, and with social accounting.

### I. Some Different Concepts of Planning

So far the most usual divisions of planning methods have been those of centralized and competitive planning. This is an oversimplification which gives no answer to some of the most important questions posed by planning. It seems to us that the practice of planning in the last thirty years has developed many more methods and types than those usually recognized in theory, or dogma.<sup>1</sup>

No country in the world has a completely planned economy, and the different degrees of planning give the economies their varied character. This is particularly important, for many economists identify planning and a planned economy with central authoritarian planning methods without asking themselves what is really centralized--the preparation of the plans, the decisions, the execution of the plans, or their control, etc. It is possible to imagine a centralized decision-making and decentralized execution; or *vice versa*, decentralized planning decisions and centralized execution.<sup>2</sup> Using the example of Yugoslavia, we shall try to show what different methods of planning have been applied, first in the Soviet type of planning, and later in the new (competitive) system. We will then go on to describe in more detail those different methods of planning which are closely connected with the problems of economic growth, such as capital formation and investment policy.

1. Some small countries, eager to copy the large Soviet Union, made plans for the same kind of industries as those in the USSR, in spite of their different economic conditions.
2. E.g., the governments of different provinces in a state make autonomous plans for the import of cotton and charge a joint agency to carry out their amalgamated plans.

## II. The Two Planning Methods in Yugoslavia

In Yugoslavia after 1945, the National Liberation Movement grew into a socialist revolution. The main instrument of accelerated development was economic planning. There were a number of reasons: (1) demographic, owing to increasing population pressure and agricultural over-population; (2) shortage of land in small family holdings, making peasant life extraordinarily difficult; (3) unused natural resources available for exploitation, and slow openings of opportunities for workers in new jobs; (4) the psychological attitude of working people eager to shake off their poverty and exploitation under conditions of early capitalist accumulation; (5) the successful political and social revolution, which brought drive and optimism to the building of socialism, and the eagerness to achieve success in economic development and in national defense, so as to preserve independence from foreign countries; and (6) the need to rebuild the country after the war, for which Allied help was forthcoming, and aid from other socialist countries expected.

When the first Five Year Plan began (1947) the new constitution had already been proclaimed and the one party system established. Eighty-two per cent of all industries had been nationalized (with the rest to follow in 1948), and so had all banking, important transport services, wholesale trade, etc. The land reform had been carried out and the main damages of war repaired.

The first period, that of Soviet type planning (1947-51) is called in Yugoslavia the period of administrative socialism, because it was carried out as if it were a matter of administrative procedure.<sup>3</sup> Some 217 Federal and Republican ministers gave orders to directors, and those in their turn to factory managers. The principle of complete unity of state administration and business management was introduced, the latter being totally subjected to the former. The number of government officials was enormously increased as compared to pre-war. Even in industry, the number of administrative staff to workers increased from pre-war 9 to post-war 15, and in commercial enterprises from 12 to 48, per hundred workers.

A. Administrative planning was long-term, consisting of a perspective Five Year Plan, with an operative plan every year, and still more detailed trimestrial plans on the state level. Shorter plans of one month, ten days, or a week, and even daily plans were made on the enterprise level. The new system used from 1952 onwards has yearly short term plans, operative in respect to national income allocation. Longer perspective plans have not been issued because of external political tension, and because of the transitory period in which the administrative economic system had to be rebuilt. This has disadvantages and allows too short a breadth to planning. At the moment, work is in progress to produce a new Five Year Perspective Plan.

B. The administrative system rested on the principle of planning according to administrative division of the state (i. e., federal, republican, local or city plans), which meant heterogeneously organized planning space with overlapping of

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3. In a way this period reminds one of the beginning of capitalism, when, under mercantilism, the activities of the enterprises were strictly regulated by government ordinances. The "withering away of the State" in economics may be to a certain extent compared to a period of liberal socialism.

plans. The new system re-established the homogeneity of spatial planning, linking the activities of the enterprise to General Social Plans at the level of the local plans (districts), and through them to larger spatial units, with only one planning authority directly involved in one area.

C. As to economic activities, in the administrative system, these were planned in detail from a central planning office, except for consumption and peasant agricultural production, in which only the compulsory delivery and taxation of the state were planned. In the new system, the General Social Plan is an estimate of future production and distribution with no compulsory character, except for the income in the socialist sector. Each enterprise, freed from bureaucratic interference, and each cooperative, autonomously decide their own plans (i. e., in the Workers' Council, or the general annual meeting of cooperators). Independent private producers are free of all interference from planning authorities; they have only to pay taxes and obey the laws.

D. In the first system, plans were carried out with ministers as the chief executives, and government officials interfered continuously with the running of current business. Every detail of supply, production, and distribution was planned centrally and directly from above. This led to arbitrariness and to interruptions in the continuity of production, to "stoppage" of commercial services, etc. (i. e., when prices were not calculated in time, or orders signed by the minister), and to lack of interest, responsibility, and initiative among the working people. As there was no limit to the administrative interference, so too there was no limit to the usefulness of planning. In the new system there is no administrative control over the current economic activities of the enterprises. The responsibility is left entirely with the management of the enterprise acting on the principle of rentability. The enterprise must obey laws and legal ordinances, within which framework it is free to act, so that only the legality, and not the opportuneness, of its decisions is subject to control. The control of the enterprise's monetary operations is in the hands of the National Bank, through which all monetary transactions have to be carried out.

E. The link between the General Social Plans and the autonomous plans of the enterprise is secured at district level. The enterprises present the estimates of their autonomous yearly plans to the planning departments of the local authority, and on the basis of these, the planning authorities prepare the economic instruments, determining the proportions in the distribution of the national income.

F. The organs of planning have also changed. In the administrative system there were powerful Planning Commissions on the Federal and Republic level, with corresponding departments in every ministry, directorate, or government office. Under the new system these organs were abolished and replaced by small planning institutes at Federal and Republic levels, as study groups for the preparation of plans but with no operative authority. All ministries were also abolished and only a few state secretariats, councils, and commissions left to care for the necessary work. Instead of economic ministries, horizontal associations of enterprises were formed on the basis of different branches, such as chambers of commerce, industries, building, transport, etc.--i. e., instead of a Ministry of Heavy Industry, there is now a section of heavy industry in the chamber of industries, and in this the heavy industry enterprises are associated. Here experiences are exchanged, overlapping trimmed down, planning discussed, policy measures proposed, and some arrangements and agreements regularizing their business activities set up. Under the administrative system of planning, every

enterprise had to supply to the superior authorities 600 to 800 different reports per year. The annual economic plan weighed some 3,300 pounds. The new planning system has reduced this to a booklet of some 40 pages. The old plan considered 16,000 groups of articles in detail; the new plan deals with 400 to 450 basic commodities. The planning board has been reduced from several thousand to a couple of hundred people.

At the same time, the General Social Plan put a stop to planning in physical terms. The new planning is being done only in financial terms, and the adjustment of supply and demand is left to the market (under specific imperfect competition). The control of planning is carried out mostly through the National Bank and the financial authorities.

To those who have lived under a system of centralized, bureaucratic, normative planning, its expense in human and economic terms and the damage which it can do at all levels of the economy are obvious. Sometimes people, particularly economists, are led astray by the bias for rationalization to the superficial assumption that centralization means greater efficiency and greater speed. The balancing of supply and demand in a centrally planned economy occurs in offices where a few people, unaware of the real effects of their authoritarian plans, become the supreme judges of the destinies of all producers and consumers through their bureaucratic machine. From this source of authority plans lead further down to smaller bodies, splitting unrealistic averages into still smaller averages, according to norms born in offices which, when they reach the enterprise level, have little resemblance to the conditions of actual life.

Out of realistic experience, the will to preserve the benefits of planning and the necessity of counteracting the dangers of the centralistic bureaucratic type, several checks have been introduced in Yugoslavia. These are: the humanizing of relations between producers and consumers; the competitive system of the market mechanism; the withering away of the state in economics, gradual as it may be; decentralized planning and the strengthening of local administration; the principle of rentability and the autonomy of the enterprise and peasant holding on the market; the autonomous business activity of the enterprise in foreign trade; and, above all, workers' management, and the disbanding of the compulsory peasant collectives.

### III. Formation of Investment Funds

In the years 1947-51 and the subsequent period 1952-55, the share of investments in the gross and net national product was the following:

|  | 1947-51 |      | 1952-55 |      |
|--|---------|------|---------|------|
|  | min.    | max. | min.    | max. |
| Gross fixed capital investment as percentage of gross national product | 28      | 33   | 29.1    | 31.6 |
| Net fixed capital investment as percentage of national income          | 28      | 30   | 21.2    | 24.4 |
| National defense expenditure as percentage of national income          | 9       | 15   | 11.9    | 20.8 |



The gross capital investment in the first period was a very large part of the gross product, and was only slightly reduced in the second period. The net investments, very high in the first period, were somewhat reduced in the second but still kept high, e.g., 24.4% in 1954. This is all the more significant if we take into account that the pre-war investment rate was calculated at (roughly) 15% of the national income. On top of this, national defense expenditure increased considerably in view of the great political tension after the 1948 break with the Soviets. Both totalled more than 40% of the national income. How was this rather large capital formation achieved in the two different planning periods?

#### A. The period of administrative planning

All private formation of capital was discouraged in both urban and rural sectors. Nationalization deprived the old capitalist class of its sources of capital formation. The modest accumulation in peasant agriculture, short of capital, was made impossible by a policy of compulsory deliveries in kind and a specific price policy. Factory wages and all salaries were low, making saving impossible.

Instead of private saving, public, compulsory (state) accumulation was established. Its main instrument was the budget, and its main sources were taxes (particularly the turnover tax) for enterprises in the socialist sector, and income tax for private income earners (mainly peasants and artisans, etc.). Altogether, 66% of the national income was controlled and distributed by the state budget. This was a centralized and planned fund in which were included all Federal, Republic, and local receipts and expenditures, giving them a small measure of budgetary autonomy. In addition, all funds which had formerly been autonomous, such as social insurance, pensions, and the insurance companies' funds, were incorporated in the state budget.

Another source of capital formation was the price policy. Industrial prices were over-estimated, and the prices paid to private peasant producers were under-estimated. Normal wages were low. Unpaid voluntary labor and compulsory labor was used for building and work in forestry.

Since direct methods of capital formation were insufficient, inflation took place. During the period of administrative planning, the dinar decreased to one-third of its 1947 purchasing power. In this way, the Five Year Plan, while purporting by law to keep prices and wages at a constant level, in fact lowered them, financing the plan to a great extent by inflation. Inflation was all the more a source of capital, because the accumulation was anticipated, being part of the planned price calculated in advance, and deducted before the goods were sold to the consumer. Some subsidiary sources of capital investment were found in the depreciation funds which were centralized in the National Bank; thus considerable dis-investment took place. A considerable source of capital investment, in amount more than one-third of the value of some branches of industry, was found in economies of scale following the concentration of enterprises, in economies in the use of internal reserves by the introduction of planning, and in the prevention of export of income from foreign capital. Great contributions to capital investment came from abroad; UNRRA alone contributed some 450 million dollars of goods, of which 145 million dollars were in machinery and equipment. Reparations from former enemy countries were another source of capital investment in this period. On the other hand, commercial and public credits from abroad were very low, and the exchange of goods with the Eastern countries was unfavorable.

### B. In the new system of planning

The process of capital formation has been greatly decentralized, though it has all the main characteristics of socialist accumulation. Individual saving deposits in the Bank began to increase, although the sum was still small. Private building activities recommenced, the peasants began to increase their livestock, buy land, and invest, albeit in very small quantities and mainly from their earnings as industrial labor.

In the socialist sector the main source of capital formation is no longer the state budget. It is the profits of the enterprises. As a matter of principle, the profits belong to society as a whole, and their redistribution is strictly regulated by the law of the General Social Plan every year. Half is taken by a profit tax, and this and another progressive extra profit belong to the Federal budget. The remaining part is distributed between the local authorities, the workers (share in profits), the autonomous funds of the enterprises, and several other funds, such as the reserve fund, enterprise investment fund, etc.

A general investment fund administered by the National Bank is now the main source of investment. Every enterprise must pay into it annually 6% of its fixed capital (with exceptions for some capital-intensive investments). Non-productive investments are still made mainly out of the government budget. A separate fund is maintained for housing, into which all enterprises pay a sum equivalent to 10% of their wage bill.

Price policy is still a source of accumulation, the purchase tax being the second largest source of income. Some consumption goods, such as textiles, etc., are heavily taxed. The price of imported goods is kept on a higher level than domestic goods, but the prices of agricultural and industrial goods came closer together in 1956. Other former sources, such as forced labor and voluntary works, were discontinued.

A source of accumulation which has increased is that of foreign aid and credits, first by tripartite aid (United States, United Kingdom, and France) amounting to 481 million dollars by the end of 1954, and later by commercial and government credits from Western and Eastern European countries, following the extension of foreign trade.

## IV. Investment Policy

The investment policy in both planning periods bore the same characteristics as to the structure of investments, as can be seen from the following table:

|                               | Gross Capital Investments (%) |      |      |      |      |
|-------------------------------|-------------------------------|------|------|------|------|
|                               | 1947-51                       | 1952 | 1953 | 1954 | 1955 |
| A. Productive investments     | 75.0                          | 92.5 | 89.4 | 81.6 | 84.5 |
| Industry and mining           | 44.3                          | 65.4 | 56.5 | 49.6 | 46.6 |
| Agriculture                   | 8.8                           | 4.1  | 5.0  | 5.0  | 7.1  |
| Transport                     | 16.6                          | 17.6 | 17.7 | 17.1 | 18.7 |
| Others                        | 5.3                           | 5.4  | 10.2 | 9.9  | 12.1 |
| B. Non-productive investments | 18.9                          | 17.5 | 10.6 | 18.4 | 15.5 |
| C. Others                     | 6.1                           | -    | -    | -    | -    |

The predominant share in investments was given to industry and mining. Agriculture was rather poorly treated until 1955, when the policy was altered and investments in agriculture began to increase. A very small share was given to non-productive investments (housing, communal services, culture, health).

Investment policy in the first five years was marked by a special psychological attitude towards investment, and this continued to a waning degree into the new planning system. Preference was given to investment on the assumption of an unlimited demand for capital (and of an unlimited reductibility of personal consumption which became a residual magnitude). All problems were supposed to be solvable only by new investment, and most of the attention of the managing and policy-making personnel was distracted from problems of current production to those of investment. In the first planning period, it was assumed that there was an unquestioned advantage of size and the rationality of centralization, (though rationalization begs the question of rational for what and for whom?). Plans for large enterprises were sometimes conceived and carried out without sufficient regard to the optimum size. The consequences of this policy were over-optimism in planned targets, installation of plants of oversized capacity, over-capitalization in newly built industries. Decisions were made centrally with no proper calculations, and the location of industry, etc., was frequently arbitrarily decided. Too large a share of capital was invested in the construction of buildings, too large an allocation for administrative offices, etc.

The reasons for such an attitude were firstly ideological, as if the building of socialism could be somehow measured by the spending of investment funds, and on the supposition that industries would create a working class.

Secondly, in a federally organized state of different nationalities, at considerably different levels of economic and demographic development, it is difficult to find a common criterion for a uniform investment policy. Centrally planned investments led to pressure on the Federal Government from all sides, and on the budget which was considered as an inexhaustible source of funds.

In order to reduce the risks, increase responsibility, and curb the appetite of exaggerated demands, decentralization of decision-making for investment was inaugurated in 1953, both vertically and horizontally. Instead of one single budget as the source of investment, one general and several separate republic and local investment funds were created. These were administered first by the National Bank, and later by a special Investment Bank, where micro-economic decisions were made according to the macro-economic allocation of investment funds in the General Social Plan. In addition, the enterprises established special autonomous investment funds apart from centralized accumulation, and were allowed to dispose of these themselves. Fixed capital investment was carried out predominantly on a selective credit basis, and interest was paid to the Bank in order to limit the demand. Circulating capital was given to enterprises entirely as short term credit. In 1957 the enterprises will get their own circulating capital.

The process of democratization in economics took the form of a debureaucratization of business management. Workers' management was established in 1950 in all enterprises, with Workers' Councils and Workers' Administrative Boards. The Workers' Council decides the yearly plan of the enterprise. The managers of enterprises are no longer appointed by ministers, but elected, after public competition, by a special committee of representatives of the Workers' Council and the District People's Committee (Local Authority). In 1953, a Producers' Council

at Federal, Republic, and local level was introduced as a second chamber of parliament.

The magnitude of the investments created some problems. The total of gross investments and defense expenditure amounted to more than 40% of the national income, a burden which no national economy (the Yugoslav included) can maintain over a prolonged period in peacetime. From 1952-55, the gross capital investment increased from 100 to 153, and the price investment goods to 133; thus the real investment expenditure increased in the same period to only 123 index. The inflationary gap is evident.

Inflationary pressure caused the prices of investment goods to increase more rapidly than the prices of other commodities. But the over-estimated investment plans had also another consequence. When the sums for investment plans were decided in the annual Social Plans on such a large scale, everybody rushed to get capital goods. But as the production of capital goods was not adequately increased, the time needed for construction was prolonged, and there was much uncompleted capital investment (for example, instead of two factories being completed, three were started and only half finished). The total inactive productive capital investment in 1955 equalled one-quarter of all fixed capital in the country.

The conclusion to be drawn from this is: had the plans for investment been smaller, more would have been built, and the economic growth would have been quicker.

As the mechanism of decentralized planning did not automatically provide ways of curbing this exaggerated investment, other measures were taken after a certain delay. In 1956 a deflationary policy was started, which was strengthened in the 1957 General Social Plan. Enterprises were ordered by law to keep reserve funds, new building could only begin when detailed plans had been presented to the Bank, and the founders of enterprises made a guaranteed deposit of a certain percentage of the investment credits demanded. Investment in all new undertakings, except those explicitly planned in the Federal Social Plan and approved by the Federal Executive Council (government) were forbidden.

All through the first planning period the consumer was under great pressure to decrease personal consumption both in quality and in quantity. In the new planning system this was continued, and from 1952 to 1955 personal consumption fell from 50.6 to 48.8 of the gross national product. These figures, however, do not show adequately the changed position of the consumer. The new system of planning put an end to the assumption of unlimited demand for consumer goods, the backbone of authoritarian planning, and re-established the position of the consumer's choice on the market. A rapid increase in the quality of goods replacing shoddy wares was the immediate consequence. Rationing by the purse did not necessarily lead to increased inequalities in consumption, as there is a considerable levelling out of personal incomes. At the same time, all groups of privileged consumers were abolished and their special shops closed. The consumer did not accept such a low rate of personal consumption without resistance, but reacted according to the specific economic conditions of the country. On the favorable side of the balance, there was a considerable switch from maize to wheat as the staple food, the use of electricity instead of kerosene for lighting, etc. There has also been an improvement in social services, education, cultural and health services, etc. The policy of low consumption level affected the productivity of labor. Factory workers and employees reacted by developing additional sources of income, i.e., working on their



own account, doing increased overtime work, having second occupations, working in agriculture, or finding other sources of complementary income, which lowered their productivity in their regular jobs. At present, regular wages amount to only 55% of the worker's income; another 28% may be added for children's allowances (paid only to those socially insured), and the rest of the income has to be earned elsewhere. For this reason real income is considerably above nominal wages.

The peasants also developed off-farm activities in factories and government employment, in cartage and other forms of supplementary work. The income from their land amounts to 60% of their family income in cash. The investment policy favoring only productive investments and neglecting investment for non-productive purposes (particularly housing and communal services) has contributed to the formation of a special hybrid group, peasant-workers, living in their own peasant households and working in factories. This group is increasing in size quickly and now comprises 12% of the total population.

### V. Economic Growth

What was the economic growth under the two systems of planning? We understand economic growth in its now conventionally accepted definition as increase of real output per head. Table I gives some figures showing this growth, measured (in constant prices) by the slope of the linear trend of time series.

The gross national product shows a constant annual increase over eight years of 4.1%, measuring from the basic year 1948.<sup>4</sup> If we take the demographic factor into account, this percentage comes to 2.1% per head. But if we divided the time series into two, according to the two planning periods, the first period (1948-51) shows a very slow real aggregate increase of 1.8; calculated per head this falls to 0.3, which is almost stagnant. On the contrary, the second period shows a very great annual rate of aggregate increase of 14%, and an annual percentage increase of 7.8% per head over the initial year (1952). The two systems of planning are only to some extent responsible for this result.<sup>5</sup> The main reason is certainly that the investments made in the first planning period brought small results in the same period, but began to bear fruit in the second. What we are anxious to stress is the fact that the absolute marginal increase of net investments was practically the same in the first and the second period of planning, and that, in spite of the high rate of investment, the real national income per head did not practically increase over the whole of the first period.

We shall briefly examine the main factors promoting this economic growth, and others which limit it.

Industrialization is mainly responsible for the economic growth that did take place, particularly in the second period. The share of industry and mining in the

4. This year was taken as the starting point, as 1947 was still a year of post-war emergency.
5. There might also be some difference in the methodology and the reliability of the estimates of the gross national product and national income in the first period. The fact that the first year of the second series (1952) was very low also had some effect.

Table I. Economic Growth in Yugoslavia, 1948-1955  
at constant 1952 prices

|  | 1948-<br>1955 | 1948-<br>1951 | 1952-<br>1955 |
|--|---------------|---------------|---------------|
| I. <u>Gross national product, constant annual increase</u>   |               |               |               |
| A. Aggregate/mrd. dinars   | 38.7          | 18.6          | 121.6         |
| B. Per head/000 dinars   | 1.3           | 0.2           | 6.0           |
| C. Percentage constant increase/basis initial year   |               |               | ?             |
| aggregate  | 4.1           | 1.8           | 14.0          |
| per head   | 2.1           | 0.3           | 7.8           |
| II. <u>National income, constant increase, fluctuations of harvest excluded</u>                              |               |               |               |
| A. Aggregate/mrd. dinars   | 31.7          | 14.0          | 83.0          |
| B. Percentage increase/basis 1948 aggregate  | 3.3           | 1.5           | 8.1           |
| III. <u>Gross fixed capital, cumulative investment, constant yearly increment aggregate/mrd. dinars</u>      | 337           | 332           | 365           |
| IV. <u>Net fixed capital investment constant cumulative yearly aggregate increment/mrd. dinars</u>           | 193           | 203           | 207           |
| V. <u>Net fixed capital productive investment constant increment aggregate/mrd. dinars</u>                   | 133           | 121           | 146           |
| VI. <u>Productivity of net capital productive investment<sup>a</sup></u>                                     |               |               |               |
| A. Capital coefficient; marginal   | 0.26          | 0.13          | 0.62          |
| B. Investment; marginal income ratio   | 3.8           | 7.7           | 1.6           |
| VII. <u>Productivity of total net capital investment</u>   |               |               |               |
| A. Capital coefficient; marginal   | 0.18          | 0.08          | 0.44          |
| B. Investment; marginal income ratio   | 5.5           | 13.0          | 2.3           |
| a. National income is increased by 10% in order to compensate for differences in methodology of calculation. |               |               |               |

national income (at constant 1938 prices) was 19.8% in 1938. In the year 1954, this percentage was increased to 35%. The number of workers employed in industry and mining increased from 1948 to 1956 by 45%, an increase far greater than that of any other group except mining.

The increase of industrialization altered the structure of industrial capital. Heavy industries grew more rapidly than light ones. In 1938 the capital engaged in basic industries (energy, metallurgy, metal and mechanical, and other basic industries) amounted to 54.5%, and in 1953 increased to 76.7%. Meanwhile the rest of industry (producing mainly consumer goods) relatively fell from 45.5% to 23.3%. Particularly striking is the example of metal and mechanical industries; their share in fixed capital was 3.4% in 1938 and rose to 11.3% in 1953. Altogether from 1948 to 1954 the new investments in power amounted to 36%, in other basic industries to 49%, and in light industries to only 15% of total investments.

This comparatively great increase of heavy industries had a considerable effect on economic growth, although electric power is still the chief bottleneck in industrial progress. It created some problems as soon as the international

situation permitted the switch from production for defense to civilian goods, and as soon as the investment policy had to be curbed because of the threat of inflation. A decelerator appeared which is intended to be smoothed by export of capital goods. But on the whole this development of industrialization required a change of policy, and indeed in 1954 the emphasis on light industries was announced. The difficulty was that investment in basic industry, once begun, is not so easy to stop, and only gradually is this change of policy showing its effect. The logical consequence of the increase of heavy industry was that the production of industrial consumer goods was not able to follow the path of increase of industrial production.

The other limiting factor is agriculture. Its structural feature, after three successive land reforms in the last 40 years (and five altogether in the last 200 years), is one of small family holdings, limited by law to a maximum of 10 hectares of cultivated land, with 96% of agricultural population owning land and 94% living in their own houses.

Collectivization never included more than 20% of cultivable land. The main reason for its failure was threefold. (1) The forcible organization of cooperatives. Before joining, many peasants decimated their livestock, and split their family holdings. Their eagerness to work slackened, and production fell, not only in co-operatives, but also in the private sector, where it reached mere subsistence level. Even the birth rate in villages fell below that in towns during the collectivization drive. (2) Agricultural over-population. There were too many people on too little land, whether under individual (family) or collective ownership. The economies of scale of collective cooperatives were not such as to counteract other disadvantages. (3) The lack of capital investment as agricultural development reached the stage where both labor-intensive and capital-intensive agriculture was required.

In 1953, collectivization stopped, the collectives were allowed to disband, the compulsory deliveries were abolished, and taxation was reformed. Agricultural production began to increase, and cooperatives of the classical type, to which some socialist elements were added (such as obligatory investment funds) spread. Progress was particularly noticeable in livestock, while the prices of grain were too low to stimulate production.

If instead of compulsory saving, to be invested through special investment funds, auto-financing in peasant agriculture were made possible, the agricultural production might increase more rapidly. As it is now the peasants do not find either money and credits, or security and stimulation enough to invest. In addition, local authorities spend the funds earmarked for agricultural improvement for other purposes, and this is a cause of continuous struggle between the central government and the local officials.

The town population, increased by industrialization and the decrease of agricultural production, created a demand for the import of food, which aggravated the over-strained balance of payments. This is the third main limiting factor in economic growth. There is a vicious circle; industrialization has created an increased demand for import of more machinery, more spare parts, raw material and fuel. Agricultural production can be increased if agricultural goods get a better and steadier price. Such an increase would augment the demand for industrial goods. But the production of such goods is limited by the lack of imports, which in their turn are hampered by the decline of agricultural production for export.

This circle requires a surgical operation. The new Five Year Plan hopes to achieve it by taking as its starting point the increase of the level of consumption of the total population. Low wages and restrained personal consumption make the increase of the productivity of labor unnecessary. If the level of wages is low, there is no need for technical improvements and higher productivity; it does not pay. Therefore, the increase of wages and salaries, and their differentiation, within the limited aim to increase the productivity of labor, is the urgent task of the new economic policy.

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CONSENSUS AND DISCUSSIONS ON ECONOMIC GROWTH:  
CONCLUDING REMARKS TO A CONFERENCE

When we first met we agreed that we would have an undisciplined conference. Here were assembled men of great scholarship and much practical experience; let them talk about whatever they thought worth talking about. We were not to be trammelled by set themes, or even by the papers which had been circulated in advance. Thus we hoped to get to grips with the problems which the group itself has found important, rather than with those which might seem important to the individuals who drew up the conference agenda.

I have found the result both surprising and illuminating. Matters on which I expected fierce controversy seemed to be taken for granted. I was surprised by the extent of your agreement. Some topics which were highly controversial five or ten years ago are no longer so. Economic development seems to be becoming a subject where general agreement is emerging.

I

Let me begin with the matters which did not provoke much discussion, though this was not always because of lack of disagreement.

My first surprise was that you by-passed the opportunity to talk about population growth which was presented by the papers of Professor Nakayama and Mr. de Jouvenel in our first session. This was a surprise because this subject is usually given a major place in conferences of this kind. Some people even take the view that it is impossible to raise the level of living without first reducing current rates of growth of population--in which case everything else that we have discussed is beside the point. I should like to think that the reason you did not discuss this issue was that you agreed on the essentials: first, that output can be made to increase faster than population is likely to increase during the next two decades; and secondly, that it is nevertheless desirable to take steps to encourage birth control in those underdeveloped areas which are already overpopulated--namely some countries of Asia, and some of the tropical islands. But I have no warrant for deducing from your silence that you must have accepted either or both of these propositions. In particular, I had hoped that we would have heard from our Japanese colleagues something about their experience, since their country has reduced enormously in recent years the rate at which its population is growing.

Next I was surprised by the absence of controversy on the relative importance of agriculture and of manufactures in economic growth. Twenty years ago--indeed, as little as ten years ago--most people thinking about these matters emphasized industrialization. If a Rip Van Winkle were to awake today from a slumber which had started in 1939, and were to tour the poorer countries of the world, he would be amazed by the importance now attached to improving agriculture, as demonstrated by vast expenditures on research, on extension, and on irrigation. Fortunately, we have not swung from one extreme to the other; we are all adherents of the "new" doctrine of "balanced growth". The circumstances which have

caused this change in the climate of opinion are well-known--post-war food shortages, balance of payments difficulties, and so on--but I am still a little surprised by the speed with which ideas have been adjusted.

Equally interesting, thirdly, is the disappearance of schemes for vast social changes in the countryside. When Rip Van Winkle went to sleep in 1939, advanced thinkers took it for granted that agricultural productivity could not be raised without greatly increasing the average size of farms, whether by collectivization as in the USSR, or by expropriating the peasants as in the British agricultural revolution--you will remember, for example, how prominently this figured in the Bombay plan. Nowadays we hear little of this. Instead, we take it for granted that agricultural productivity can be increased sharply--doubled, some say--without changing the farm unit, by such means as new seeds, more water, fertilizers, disease control, etc. These are the priorities of today. This change of climate is due to two things in particular. First, to recognition of the great success achieved by this country, Japan, in raising agricultural productivity without increasing the size of farms; and secondly, to reluctance to embark upon fighting the peasants, in an effort to alter farm structures, when this fight is not necessary. Moreover, we recognize that the small size of farms in Asia is due to rural overpopulation. If other industries expand rapidly enough, labor will be withdrawn from the countryside, and farm size will increase automatically; but, until we can dispose of the rural surplus by providing employment elsewhere, it is pointless to try to move it off the farms.

This complacency towards schemes for reconstructing the unit of farming did not extend to schemes for altering the relationship between landlord and tenant. It seems to be generally taken for granted that we need to have considerable land reform, if not abolishing landlords altogether, at least protecting the tenant farmers in various ways. Such skepticism as was expressed was mostly (but not exclusively) on the political level, as to whether this is feasible in the current political situation in many countries, where the farmers do not have enough political power to put through changes of this kind.

Let us turn next to industrialization. You seemed to agree unanimously with Professors Hoselitz and Molinari that the big cities are growing much too rapidly; and that there should be measures to ensure that urbanization produces a large number of medium-sized cities, rather than a small number of giants. But when we turned from comparing large cities with small cities, to comparing factory industry with cottage industry, the group split wide open. I thought two valid points were made, one on each side. In those Asian countries where there is already unemployment in handloom weaving and other cottage industries, side by side with a shortage of capital for some purposes which cannot be operated on a cottage basis (steel, large-scale irrigation, engineering, etc.), it is clearly uneconomic to allow capital to do what the cottage workers could do just as well. This is the case for confining capital investment at present to spheres with which cottage industry cannot cope. It is only a temporary case; for in due course the expansion of the rest of the economy will increase the demand for consumer goods beyond the supply which the cottage industries can produce, thus raising the marginal productivity of capital investment in such consumer goods industries. On the other side lies the argument which goes back to Ricardo's famous chapter on machinery. All capital formation is financed out of saving, and saving is done mainly by capitalists and not by cottage workers. Hence the way to increase saving is to extend capitalist production at the expense of cottage industry; thus creating a surplus (profits) over wages, the reinvestment of which will

cause unemployment to expand. This argument is powerful in any community where savings must come mainly out of private profits; but it is less compelling where saving is done equally by all classes of the community, or is done by the public sector out of taxes and public profits.

Next, how fast should we try to go? In my introductory paper, I suggested that an appropriate target is that national income should increase by 2 per cent per head per year. None of you took this up, except Professor Gadgil, who suggested, in effect, that the question is inappropriate. We should plan to make the best use of our resources, and whether the result is growth at 1 per cent per annum or at 5 per cent per annum, we shall have done the best we can. This approach accorded with the skepticism expressed by Dr. Martin as to the usefulness of capital-output ratios. Since we do not know how much capital is required to raise output by X per cent per annum, we must be skeptical of plans which fix definite targets. We were all sympathetic to these points of view--surprisingly sympathetic, since a majority of us have been connected with public documents which purport to fix such targets.

On the other hand, to say that we must make the best use of our resources merely pushes the question back. The rate of growth depends partly on how much is invested in people (education, research, public health, etc.) and partly on how much is invested in capital formation. How large our resources for development will be depends upon how much we devote to these purposes, so we cannot evade the question as to how much should be devoted to economic growth. There was unanimous agreement that the underdeveloped countries must make the largest effort that they can, within the limits of democracy. These countries have to pull themselves up by their own bootstraps. They will receive some aid from the richer countries, but the major effort they will have to make themselves. I argued in my paper that, the propensity to save being low, the governments of these countries must resort to compulsory saving: specifically, that they should seek to raise about 20 per cent of the national income in taxes, using about 12 per cent for current expenditure, and using the rest partly to finance public works and enterprises, and partly to lend to private investors in agriculture, in manufacturing, and in housing. Mr. Bauer dissented, regarding compulsory saving as inconsistent with democracy; but the rest of you, while not committing yourselves to figures, seemed to agree that the governments of these countries should raise much more than they do in taxes, in order to pay for economic development.

Finally, we came to the subject of economic planning. Here again, Rip Van Winkle would have been ill at ease. In the decade of the 1940's, physical planning was adopted all over the world to cope with the problems created by the war. It was then widely, but not universally assumed that much of this change was permanent; that hereinafter every well ordered community would be governed by a plan, laying down the appropriate use of each resource, and that the plan would be operated through a network of licensing authorities. But in the 1950's a reaction set in. It was argued that the planning authorities do not know better than a market economy how resources should be used. Even if they do know better, they will fail if they prescribe uses for resources which are unprofitable to the individuals who control the resources. Hence such planning as is done should proceed by making it profitable for individuals to do what the planners wish them to do. In which case, there is no need for licenses; planning is done through manipulating market prices, by taxes and subsidies. I had expected this battle to be fought out in this conference, but it was not. You took it for granted that the government would have little to say about the appropriate use of private resources, and that, insofar as it

was planning the use of private resources it would operate mainly through financial inducements, rather than through licensing.

The Planning Commissions, whose number has so rapidly multiplied in recent years, are concerned mainly with planning the use of government resources and only to a small extent with private resources. Since many economists serve on these commissions, we had a short discussion of the contribution economists can make. The principal task set to these commissions is to determine priorities. Our discussion was on a pessimistic level. Economists as such do not know what is the right priority as between schools, hospitals, roads or factories, so they have not much to contribute on the subject of priorities. Moreover, whatever economists may say, priorities are in fact determined by political pressures. The best that economists can do is to try to ensure that the various parts of a program are not wholly inconsistent with each other. And, since the demand for resources is bound to exceed the supply, they can keep reminding governments that it is necessary to have an adequate level of taxation if the cost of economic development is to be met.

## II

Let us turn now to the matters on which there was sharp disagreement. That there were only three major issues is a tribute to the extent to which our subject has grown up: actual experience in planning economic development has brought wider agreement on what is feasible. Nevertheless the three remaining are crucial issues.

First, we had an extended debate on the role of education in particular, and of social services in general, in development programs. We noted wide divergences: the Indian government spends less than one per cent of national income on education, whereas the Ghana government spends over three per cent. There was general agreement that money should be spent on education insofar as it is directed to economic expansion--on technical schools, on agricultural extension, on some kinds of university training, and so on. The controversy turned more particularly on elementary education: where half or more of the children are out of school, should one set the target for universal education five years ahead, or fifteen years ahead, or fifty?

Two arguments were put forward for restraining education expenditures at present. First, on the technical level, since the number of trained teachers cannot be expanded rapidly, rapid expansion of the number of pupils is possible only by reducing the standards of teacher training. Secondly, on the economic level, it was argued that poor countries cannot afford to pay for universal education. It is better to use their limited resources to increase the output of food and of other consumer goods; and only when there is a larger surplus will it be possible to maintain a large body of primary school teachers.

There were also two arguments on the other side. First, the distinction between economic and other education was challenged. We do not know the economic effects of education, and we cannot say whether the level of economic education responds to 20 per cent, 50 per cent, or 100 per cent of children in school. Education is a cause of mental ferment, and since there is no reason to believe that the children in school are better economic subjects than those out of school, we have no reason to assume other than that its results are proportionate to its coverage.



The countries where growth is most rapid have all accorded priority to education. E.g., Japan adopted compulsory education in 1870. Secondly, the equation between education and other goods and services was also challenged; if the choice is between more education on the one hand, and more textiles or bicycles or radios on the other, then education should come first. This is a subjective judgment, according priority to education on non-economic grounds. Some argued that education is necessary to preserve democracy, but others found no historical correlation between these two.

I know of no way of resolving this dispute. India and Pakistan are going one way, while Ghana and Nigeria go the other way. There are no doubt political reasons explaining this divergence. At the same time, if we cannot say whether education should receive one per cent or three per cent of national income (and the same goes for expenditure on public health), we cannot be very helpful in determining what priorities should be.

The second subject on which we divided is the effect of equalitarianism upon the rate of economic growth. This subject was raised the first morning, and we had to return to it when we discussed taxation, and again when we came to the role of trade unions. Inequality of earned income is not the main problem; we all agree that incentives are needed for growth. The problem is rather unearned income--the surplus over wages and salaries which accrues to property-owners as interest, rent, and profit. This amounts to about a third of the national income in Asian countries, and it plays a crucial role in economic expansion.

Economic growth requires that there should be a surplus over consumption. If the peasants and the working classes had a sufficiently large propensity to save, they could finance economic growth without any concentration of wealth in the hands of the few. However, since their propensity to save is inadequate, private capitalism has been financed through a large surplus accruing in the hands of a few people, who save and re-invest part of it. Thus the expansion of private capitalism has everywhere been accompanied by the growth of huge private fortunes in the hands of a few.

Our conference reflected all the usual reactions to this situation. There were those amongst us who think it good to have some rich men, whether because they may patronize art, or because they may resist encroachments of the state on individual liberty. There were also those who seek not equality, but equality of opportunity; to these, differences of wealth act as a spur to effort, provided that stiff inheritance taxes start the game afresh in each generation. And there were among us socialists, to whom it is an anathema that the surplus value should accrue to private ownership; to these, the surplus is produced by the whole community, and should belong to the whole community. We could not hope to resolve these differences in our conferences; nor was it necessary to do so. For economic growth will occur whether the source of savings is the private wealth of a few rich persons or whether it derives from the surpluses of public undertakings and of tax revenues. To argue that growth is possible only where private profit is allowed, or only where the surplus is socialized, would be patently contrary to contemporary facts.

Finally, we did not agree on what for some is the supreme political question. Some maintain that sustained growth is not possible for long in totalitarian countries; others maintain that the rate of growth can be higher in totalitarian than in democratic countries, since the totalitarians can enforce measures which would

not be tolerated in a democratic set-up. However, this difference was not important to us, since we all agreed that at the margin democracy is more important than growth; none of us wishes to proceed more rapidly than a democratic framework would allow.

The question which then arises is, how can a democracy attain the highest rate of growth of which it is capable? What are the conditions for securing the assent of public opinion to painful measures--such as high taxes, or rationing of foreign exchange? Are the newly independent countries of Asia and of Africa likely to remain democratic, and if so, will the pursuit of firm economic policies strengthen or weaken the position of courageous leaders? We were not able to answer these questions. Some of us were pessimistic; others were optimistic. Probably the answer is that democracy will fare differently in different countries.

I think we achieved all that we set out to do. We cleared our minds on a number of technical economic problems. We also agreed that adequate growth is possible within the democratic framework; that we need not resort to totalitarian measures in order to raise agricultural productivity or to stimulate industrialization, or to secure adequate savings. Whether the democratic governments of Asia and of Africa will rise to the occasion is a different question, which it was not our main purpose to answer. We are all inspired by the good examples which some of these governments are already setting. It remains to be seen whether others will learn from their achievements.

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